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Supreme Court, U.S.

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**In the Supreme Court of the United States**

OCTOBER TERM, 1971

**No. 70-305**

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

FIRST SECURITY BANK OF UTAH, N.A., *et al.*

ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI  
FILED JUNE 18, 1971

CERTIORARI GRANTED OCTOBER 12, 1971





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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE TENTH CIRCUIT

## INDEX

	Page
Relevant Docket Entries in Tax Court Docket No. 1190-63	1
Relevant Docket Entries in Tax Court Docket No. 1216-63	2
Relevant Docket Entries in the United States Court of Appeals for the Tenth Circuit	4
Petition—Docket No. 1190-63	5
Petition—Docket No. 1216-63	9
Answer—Docket No. 1190-63	14
Answer—Docket No. 1216-63	15
Stipulation of Facts	16
Transcript of Proceedings:	
Excerpts from Opening Statements	23
Excerpts from Colloquy between Court and Counsel	23
Testimony of W. Larry Harlan	24
Testimony of George S. Eccles	38
Testimony of Thomas F. Hawkes	69
Testimony of Phil J. Hermansen	75
Testimony of Arthur Crooks Eddy	86
Testimony of Clarence H. Tookey	101
Testimony of W. Larry Harlan	128
Respondent's Exhibits:	
AQ—Letter to Harlan from Hawkes	129
AR—Letter to Eccles from Harlan	130

	Page
AS—Letter to Harlan from Hawkes	131
BE-37—Minutes of Executive Committee Meeting	133
BV-45—Schedule of Commissions Paid	136
Petitioners' Exhibits:	
53—Examiner's Comment	137
54—Banking Law	139
56—Letter to Harlan from Steffensen	141
58—Chart—Gross Premium Elements	145
59—Graph	147
60—Graph	149
61—Chart	151
62—Chart	152
63—Graph	153
66—Chart	155
67—Chart	157
68—Organizational Chart	159
Joint Exhibit:	
CH-51—Comparison of Stock Ownership	161
Findings of fact and opinion of Tax Court	163
Decision of Tax Court—Docket No. 1190-93	177
Decision of Tax Court—Docket No. 1191-63	178
Decision of Tax Court—Docket No. 1216-63	178
Notice of Appeal—Docket No. 1190-63	179
Notice of Appeal—Docket No. 1191-63	180
Notice of Appeal—Docket No. 1216-63	181
Opinion of Court of Appeals	182
Judgment of Court of Appeals	193
Order of Supreme Court Granting Certiorari	194

TAX COURT OF THE UNITED STATES

DOCKET No. 1190-63

FIRST SECURITY BANK OF UTAH, N.A., *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

RELEVANT DOCKET ENTRIES

Date	Filings and Proceedings
Mar. 20, 1963	PETITION FILED: FEE PAID; Served March 20, 1963
May 2, 1963	ANSWER FILED by Respondent; Served May 6, 1963
Feb. 8, 9, 1967	TRIAL at San Francisco, California by Judge Fay
Feb. 8, 9, 1967	Petr. oral motion to compel election by resp. between alternative remedies—DENIED. Petrs. motion to exclude issue or, in the alternative, to shift burden of proof—Filed, Denied and Served Feb. 9, 1967. (In 1190-63 & 1216-63 Only). Petr. motion to exclude issue or, in the alternative to shift burden of proof—Filed, Denied and Served Feb. 9, 1967. (In 1190-63, 1191-63 & 1216-63).
	STIPULATION Filed. STIPULATION OF FACTS Filed. SECOND SUPPLEMENTAL STIPULATION OF FACTS filed.
Mar. 3, 1967	ORDER, that (Dkts. 1190-63, 1191-63 & 1216-63) are hereby consolidated for purposes of trial, briefs and opinion.
Dec. 27, 1967	MEMORANDUM FINDINGS OF FACT AND OPINION filed Judge Fay.

Date	Filings and Proceedings
Jan. 26, 1968	MOTION by petr. to alter and amend findings and for reconsideration. DENIED March 19, 1968.
May 7, 1969	DECISION entered, Judge Fay. Served May 7, 1969
July 28, 1969	NOTICE of appeal to U.S.C.A., 10th Cir., filed by Petrs. Served July 29, 1969

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TAX COURT OF THE UNITED STATES

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DOCKET No. 1216-63

FIRST SECURITY BANK OF IDAHO, N.A., *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

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RELEVANT DOCKET ENTRIES

Date	Filings and Proceedings
Mar. 21, 1963	PETITION FILED: FEE PAID Mar. 21, 1963; Served Mar. 21, 1963
May 2, 1963	ANSWER filed by Resp. Served May 6, 1963
Feb. 8, 9, 1967	TRIAL at San Francisco, California by Judge Fay.
Feb. 8, 9, 1967	Petr. oral motion to compel election by resp. between alternative remedies—DENIED. Petrs. motion to exclude issue or, in the alternative, to shift the burden of proof—Filed, Denied and Served Feb. 9, 1967. (In 1190-63 & 1216-63 only). Petr. motion to exclude issue or, in the alternative to shift the burden of proof—Filed, Denied and Served Feb. 9, 1967. (In 1190-63, 1191-63 & 1216-63).

Date

Filings and Proceedings

**STIPULATION FILED. STIPULATION OF FACTS filed. SECOND SUPPLEMENTAL STIPULATION OF FACTS filed.**

March 3, 1967 **ORDER**, that (Dkts. 1190-63, 1191-63 & 1216-63) are hereby consolidated for purposes of trial, briefs and opinion.

Dec. 27, 1967 **MEMORANDUM FINDINGS OF FACT AND OPINION** filed Judge Fay.

Jan. 26, 1968 **MOTION** by petr. to alter and amend findings and for reconsideration. **DENIED** March 19, 1968.

May 7, 1968 **DECISION** entered, Judge Fay. Served May 7, 1969.

July 31, 1969 **NOTICE OF Appeal** to U.S.C.A., 10th Cir. filed by Petr. Served Aug. 1, 1969.

Aug. 6, 1969 **NOTICE** of Appeal to U.S.C.A., 9th Cir. filed by Petr. Served Aug. 7, 1969.

Oct. 8, 1969 **STIPULATION OF VENUE** to U.S.C.A., 10th Cir. filed.

UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

Docket Nos. 611/69 and 612/69

[Caption Omitted]

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RELEVANT DOCKET ENTRIES

Date	Filings—Proceedings
11/3/69	Cause docketed; leave granted to docket out of time—WLW
11/4/69	Assigned to General Calendar
12/15/69	Appellant's brief
3/3/70	Brief of Appellee
4/14/70	Appellant's Reply brief
9/21/70	Argued and submitted—Breitenstein, Seth, Templar
1/21/71	Opinion, <i>Breitenstein</i> ; Seth; Templar, Dist. Judge; Judgment: Reversed.
2/12/71	Mandate and original record on appeal to Clerk



IN THE TAX COURT OF THE UNITED STATES

[Caption Omitted]

PETITION

Docket No. 1190-63

(Filed March 20, 1963)

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Form L-21A Ap:SLC:WBH-90D:BLG) dated December 21, 1962, and as a basis for its petition alleges as follows:

1. Petitioner is a national bank, with its principal office at 79 South Main Street, Salt Lake City, Utah. The federal income tax returns for the taxable years here involved were filed with the District Director for the Utah District at Salt Lake City, Utah.

2. The notice of deficiency, a copy of which is attached hereto and marked Exhibit A, was mailed to the petitioner on December 21, 1962.

3. The deficiencies, as determined by the Commissioner, are in income taxes for the taxable years ending December 31, 1954, to and including December 31, 1959, in the total aggregate amount of \$497,953.34, all of which said amount is in dispute. The following table shows the amount of the deficiency determined for each of the taxable years:

Year	Deficiency
1954	\$ 68,250.00
1955	28,775.81
1956	54,526.56
1957	77,862.91
1958	159,371.46
1959	109,166.60
	<u>\$497,953.34</u>

4. The determination of deficiencies in tax set forth in the said notice of deficiency is based upon the following errors:

(b) The Commissioner erred in determining for the

taxable years 1955, 1956, 1957, 1958 and 1959 that the insurance premiums and/or commission income reported as income by the First Security Life Insurance Company of Texas, a corporation, or any part of it, should have been reported by petitioner and that therefore petitioner's taxable income and its tax liability for each of the taxable years 1955 to and including 1959 should be increased as set forth in the following table:

Year	Taxable Income	Tax Liability
1955	\$ 55,338.08	\$ 28,775.81
1956	104,858.79	54,526.56
1957	149,736.36	77,862.91
1958	306,483.59	159,371.46
1959	209,935.77	109,166.60

5. The facts upon which petitioner relies as a basis of this case are as follows:

(b) The said deficiency notice completely fails to set forth any of the factual or legal grounds upon which the Commissioner has based his determination that petitioner should report as its own the indicated income of First Security Life Insurance Company of Texas for the taxable years 1955 through 1959. The Commissioner's determination is therefore arbitrary and capricious. Moreover, it is impossible for petitioner, without indulging in speculation, to make responsive factual allegations except to state that petitioner is not, was not and cannot be in the insurance business, and does not and did not have any contract or agreement or understanding with any insurance company which entitled it in the taxable years involved to receive any insurance premiums and/or commission income that was paid to the First Security Life Insurance Company of Texas.

Wherefore, petitioner prays that this Court determine that there is no deficiency in income tax for any of the taxable years 1954, 1955, 1956, 1957, 1958 and 1959.

Respectfully submitted,

C. PRESTON ALLEN

ALONZO W. WATSON, JR.

*Attorneys for Petitioner*

c/o Ray, Quinney & Nebeker

Verified



## Exhibit A

U.S. Treasury Department, Internal Revenue Service,  
Office Of Regional Commissioner.

Appellate Division 400 Tribune Building, Salt Lake City  
11, Utah.

In Reply Refer to Form L-21A Ap:SLC:WBH-90D:BLG  
Certified Mail Dec 21 1962

First Security Bank of Utah, N. A. c/o Mr. C. Preston  
Allen, c/o Ray, Quinney & Nebeker, 300 Deseret Building,  
Salt Lake City 11, Utah.

Gentlemen: Taxable Year Ended	Deficiency
12-31-54	\$ 68,250.00
12-31-55	28,775.81
12-31-56	54,526.56
12-31-57	77,862.91
12-31-58	159,371.46
12-31-59	109,166.60
	<u>\$497,953.34</u>

In accordance with the provisions of existing internal revenue laws, notice is given that the determination of your income tax liability for the above-noted taxable year(s) discloses a deficiency (or deficiencies) in the amount(s) shown above. The attached statement shows the computation of the deficiency or deficiencies.

If You Agree to this determination, please sign the enclosed agreement, Form 870, and return it promptly to this office. An addressed envelope is enclosed for this purpose. The signing and filing of this agreement will permit an early assessment of the deficiency or deficiencies and will limit the accumulation of interest.

If You Do Not Agree, and do not sign and return the enclosed form, the deficiency or deficiencies will be assessed for collection, as required by law, upon the expiration of ninety days from the date of this letter, unless within that time you contest this determination in the Tax Court of the United States by filing a petition with that Court in accordance with its rules, a copy of which may be obtained by writing to its Clerk, Box 70, Washington 4, D.C.

Very truly yours,

MORTIMER M. CAPLIN

Commissioner

By DENVER E. WATSON

Associate Chief, Appellate Division

Enclosures: Statement; Agreement, Form 870; Addressed envelope.

### Statement

Ap: SLC:WBH  
90-D:BLG

First Security Bank of Utah, N. A., c/o Mr. C. Preston Allen, Ray, Quinney & Nebeker, 300 Deseret Building, Salt Lake City 11, Utah.

Tax Liability for the Taxable Years Ended December 31, 1954 to December 31, 1959, Inclusive.

Year		Deficiency
1954	Income Tax	\$ 68,250.00
1955	Income Tax	28,775.81
1956	Income Tax	54,526.56
1957	Income Tax	77,862.91
1958	Income Tax	159,371.46
1959	Income Tax	109,166.60
		<u>\$497,953.34</u>

In making this determination of your income tax liability, careful consideration has been given to your protests dated October 1, 1959, and June 12, 1961, and to the statements made at the conferences held on September 26, 1962, and prior dates.

A copy of this letter and statement has been mailed to your representatives, S. J. Quinney, Paul H. Ray, C. Preston Allen, Lynn E. Baxter, Gordon L. Barney, and Alonzo W. Watson, Jr., c/o Ray, Quinney & Nebeker, 300 Deseret Building, Salt Lake City 11, Utah, in accordance with the authority contained in the power of attorney executed by you.

IN THE TAX COURT OF THE UNITED STATES

[Caption Omitted]

PETITION

Docket No. 1216-63

(Filed March 21, 1963)

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Form L-21A Ap:SLC:WBH-90D:BLG) dated December 21, 1962, and as a basis for its petition alleges as follows:

1. Petitioner is a national bank, with its principal office at 905 Idaho Street, Boise, Idaho. The federal income tax returns for the taxable years here involved were filed with the District Director for the Idaho District at Boise, Idaho.

2. The notice of deficiency, a copy of which is attached hereto and marked Exhibit A, was mailed to the petitioner on December 21, 1962.

3. The deficiencies as determined by the Commissioner are in income taxes for the taxable years ending December 31, 1954, 1955, 1957 and 1958, in the total aggregate amount of \$357,535.08, all of which said amount is in dispute. In addition, the Commissioner on page 2 of the Statement attached to his said notice of deficiency has determined as an adjustment to income for the taxable year 1959 that petitioner had insurance premium receipts of \$135,353.32, and reduced the operating loss of \$1,143,485.81 reported by petitioner on its income tax return for 1959 by said amount of \$135,353.32. Petitioner contends that the said adjustment to income for the taxable year 1959 is also erroneous and that its operating loss for said year should be increased by the said \$135,353.32. Furthermore, on said page 2 of said deficiency notice, the Commissioner determined as an adjustment to income for the taxable year 1956 that petitioner had insurance premium receipts of \$79,751.75, which increased the amount of taxable income against which part of petitioner's net operating loss deduction for 1959 was applied. Petitioner contends that the said adjustment for the said taxable year 1956 is also erroneous and that there-

fore it should have a larger net operating loss to apply against its tax liability for the year 1957. The following table shows the amount of the deficiency determined for each of the taxable years:

Year	Deficiency
1954	\$ 68,250.00
1955	26,139.85
1957	160,392.56
1958	102,752.08
	<u>\$357,535.08</u>

4. The determination of deficiencies in tax set forth in the said notice of deficiency is based upon the following errors:

(b) The Commissioner erred in determining that for the taxable years 1955, 1956, 1957, 1958 and 1959 that the insurance premiums and/or commission income reported as income by First Security Life Insurance Company of Texas, or any part of it, should have been reported by petitioner, and that therefore petitioner's taxable income for each of the taxable years 1955 to and including 1959 should be increased as set forth in the following table:

Year	Taxable Income
1955	\$ 50,268.95
1956	79,751.75
1957	93,342.14
1958	197,601.26
1959	135,353.32

5. The facts upon which petitioner relies as a basis of this case are as follows:

(b) The said deficiency notice completely fails to set forth any of the factual or legal grounds upon which the Commissioner has based his determination that petitioner should report as its own the indicated income of First Security Life Insurance Company of Texas for the taxable years 1955 through 1959. The Commissioner's determination is therefore arbitrary and capricious. Moreover, it is impossible for petitioner, without indulging in speculation,

to make responsive factual allegations except to state that petitioner is not, was not and cannot be in the insurance business, and does not and did not have any contract or agreement or understanding with any insurance company which entitled it in the taxable years involved to receive any insurance premiums and/or commission income that was paid to the First Security Life Insurance Company of Texas.

Wherefore, petitioner prays that this Court determine

1. That there is no deficiency in income tax for any of the taxable years 1954, 1955, 1957 and 1958; and

2. That petitioner's operating loss for 1959 be increased in the amount of \$135,353.32 and its net operating loss available for the taxable year 1957 be increased in the amount of \$215,105.07.

Verified

Respectfully submitted

C. PRESTON ALLEN

ALONZO W. WATSON, JR.

Attorneys for Petitioner

c/o Ray, Quinney & Nebeker

#### Exhibit A

U.S. Treasury Department, Internal Revenue Service,  
Office Of Regional Commissioner.

Appellate Division 400 Tribune Building, Salt Lake City  
11, Utah.

In Reply Refer to Form L-21A Ap:SLC:WBH-90D:BLG.  
Certified Mail Dec 21 1962

First Security Bank of Idaho, N. A., c/o Mr. C. Preston  
Allen, Ray, Quinney & Nebeker, 300 Deseret Building, Salt  
Lake City, Utah.

Gentlemen:	Taxable Year Ended	Deficiency
	12-31-54	\$ 68,250.00
	12-31-55	26,139.85
	12-31-57	160,392.56
	12-31-58	102,752.67
		<u>\$357,535.08</u>

In accordance with the provisions of existing internal revenue laws, notice is given that the determination of your



income tax liability for the above-noted taxable year(s) discloses a deficiency (or deficiencies) in the amount(s) shown above. The attached statement shows the computation of the deficiency or deficiencies.

If You Agree to this determination, please sign the enclosed agreement, Form 870, and return it promptly to this office. An addressed envelope is enclosed for this purpose. The signing and filing of this agreement will permit an early assessment of the deficiency or deficiencies and will limit the accumulation of interest.

If You Do Not Agree, and do not sign and return the enclosed form, the deficiency or deficiencies will be assessed for collection, as required by law, upon the expiration of ninety days from the date of this letter, unless within that time you contest this determination in the Tax Court of the United States by filing a petition with that Court in accordance with its rules, a copy of which may be obtained by writing to its Clerk, Box 70, Washington 4, D.C.

Very truly yours,

MORTIMER M. CAPLIN

*Commissioner*

By DENVER E. WATSON

*Associate Chief, Appellate Division*

Enclosures: Statement; Agreement, Form 870; Addressed envelope.

### Statement

Ap:SLC:WBH

90-D:BLG

First Security Bank of Idaho, N. A., c/o Mr. C. Preston Allen, Ray, Quinney & Nebeker, 300 Deseret Building, Salt Lake City 11, Utah.

Tax Liability for the Taxable Years Ended December 31, 1954, December 31, 1955, December 31, 1957, and December 31, 1958.

Year	Income Tax	Deficiency
1954		\$ 68,250.00
1955	Income Tax	26,139.85
1957	Income Tax	160,392.56
1958	Income Tax	102,752.67
Total		\$357,535.08

In making this determination of your income tax liability, careful consideration has been given to your protest dated June 8, 1961; to the statements made at the conferences held on August 11, 1961, February 16, 1962, March 22, 1962, August 14, 1962, August 28, 1962, and September 26, 1962; and to your claim for refund, Form 1139, filed on March 8, 1960.

A copy of this letter and statement has been mailed to your representatives, S. J. Quinney, Paul H. Ray, C. Preston Allen, Lynn E. Baxter, Gordon L. Barney, and Alonzo W. Watson, Jr., c/o Ray, Quinney & Nebeker, 300 Deseret Building, Salt Lake City, Utah, in accordance with the authority contained in the power of attorney executed by you.

**TAX COURT OF THE UNITED STATES**

**[Caption Omitted]**

**ANSWER**

**Docket No. 1190-63**

**(Filed May 2, 1963)**

The Respondent, in answer to the petition filed in the above-entitled case, admits and denies as follows:

1, 2, and 3. Admits the allegations of paragraphs 1, 2, and 3 of the petition.

4 (a) and (b). Denies the allegations of error in subparagraphs 4 (a) and (b) of the petition.

5 (a) and (b). Denies the allegations in subparagraphs 5 (a) and (b) of the petition.

6. Denies generally each and every allegation of the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the deficiency determined by the respondent be in all respects approved.

**Of Counsel:**

**MELVIN L. SEARS**

**Regional Counsel**

**JAMES BOOHER**

**Attorney**

**Internal Revenue Service**

**CRANE C. HAUSER**

**Chief Counsel**

**Internal Revenue Service**

**Served May 6 1963**



## TAX COURT OF THE UNITED STATES

[Caption Omitted]

## ANSWER.

Docket No. 1216-63

(Filed May 2, 1963)

The Respondent, in answer to the petition filed in the above-entitled case, admits and denies as follows:

1 and 2. Admits the allegations of paragraphs 1 and 2 of the petition.

3. Admits that the deficiencies as determined by the Commissioner are in income taxes for the taxable years ending December 31, 1954, 1955, 1957 and 1958, in the total aggregate amount of \$357,535.08, all of which said amount is in dispute; that the Commissioner made adjustments to petitioner's reported income as set forth in the statutory notice of deficiency and that the following table shows the amount of the deficiency determined for each of the taxable years:

Year	Deficiency
1954	\$ 68,250.00
1955	26,139.85
1957	160,392.56
1958	102,752.08
	<u>\$357,535.08</u>

Denies the remaining allegations of paragraph 3 of the petition.

4 (a) and (b). Denies the allegations of error in subparagraphs 4 (a) and (b) of the petition.

5 (a) and (b). Denies the allegations in subparagraphs 5 (a) and (b) of the petition.

6. Denies generally each and every allegation of the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the deficiency determined by the respondent be in all respects approved.

CRANE C. HAUSER

Chief Counsel

Internal Revenue Service

Of Counsel: Melvin L. Sears, Regional Counsel; James Booher, Attorney, Internal Revenue Service.

## STIPULATION OF FACTS

[Caption Omitted]

It is hereby stipulated that, for the purposes of these cases, the following statements may be accepted as facts and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated, and that either party may object to the relevancy or materiality of these statements or exhibits.

1. On December 21, 1962, respondent mailed a notice of deficiency to each of the petitioners. Correct copies of the deficiency notices mailed to each of the petitioners are attached hereto as Exhibit CC-48 and made a part hereof.

2. The petitions filed by the respective petitioners herein were timely filed according to law, and these consolidated actions are in all respects properly before the Court.

3. Petitioners filed income tax returns with the District Director of Internal Revenue Service, at Salt Lake City, Utah, or Boise, Idaho, as follows:

Petitioner	Years for Which Returns Filed	Filed with District Director of Internal Revenue at
First Security Bank of Utah, N. A.	1954-1959	Salt Lake City
First Security Bank of Idaho, N. A.	1954-1958	Boise
First Security Company	1956-1959	Salt Lake City

Each petitioner's principal place of business, when its petition was filed, was as follows:

Petitioner	Principal Place of Business
First Security Bank of Utah, N. A.	Salt Lake City, Utah
First Security Company	Salt Lake City, Utah
First Security Bank of Idaho, N. A.	Boise, Idaho

4. From 1954 through October, 1959, petitioners were wholly-owned subsidiaries of the First Security Corporation, a publicly-owned bank holding company. During these years, First Security Corporation had approximately 1,044,963 shares of common voting stock outstanding and from 2,000 to 3,000 shareholders residing in various states and foreign countries.

5. Petitioner First Security Bank of Utah, N. A., is a national bank incorporated in 1882. It is subject to supervision, inspection and control by the Board of Governors, Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of Currency, and is regularly examined by these agencies. During the years in issue, this bank had numerous branches, approximately 141,000 to 192,000 depositors, and approximately \$217,000,000 to \$292,000,000 in deposits.

6. Petitioner First Security Bank of Idaho is a national bank, incorporated as such in 1941, after operating since 1865 as a state bank. It is subject to supervision, inspection and control by the Board of Governors, Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of Currency, and is regularly examined by these agencies. During the years in issue, this bank had numerous branches, approximately 113,000 to 131,000 depositors, and approximately \$183,000,000 to \$205,000,000 in deposits.

7. Petitioner First Security Company is a management company organized under the laws of the state of Utah in 1929. This corporation is subject to control, supervision and inspection by the Board of Governors of the Federal Reserve System and regularly inspected by this agency. This company provides management and related services (e.g., accounting, auditing and supervisory assistance) to related banking subsidiaries of the First Security Corporation.

8. From 1954 through October, 1959, First Security Corporation's wholly-owned subsidiaries, in addition to petitioners, included:

(a) The first Security Life Insurance Company of Texas (hereinafter called Security Life), a corporation organized and licensed as an insurance company pursuant to the laws of Texas on or about June 15, 1954. At incorporation, Security Life had a paid-in capital of 2,500 shares of \$10

par value common stock and a paid-in surplus of \$12,500. Its capital was increased in 1956 to \$100,000.

(b) Ed D. Smith & Sons (hereinafter called Smith), a Utah corporation. First Security Corporation acquired Smith in 1948. During the years in issue Smith had approximately twenty employees, sold life and casualty insurance, and reported for federal income tax purposes a gross income of between \$152,000 and \$303,000. Its yearly premium volume was approximately \$800,000.

(c) First Security Insurance Agency, Inc. (hereinafter called Agency, Inc.), an Idaho corporation. First Security Corporation acquired Agency, Inc. on or about August 10, 1946. During the years in issue, this corporation sold insurance and had yearly premium volume of approximately \$175,000.

(d) First Security State Bank, a Utah state bank, with approximately 9,500 to 11,000 depositors and \$9,000,000 in deposits. First Security Corporation acquired this bank on or about October 21, 1957. This bank is subject to supervision, inspection, and control by the Utah State Banking Department and Federal Deposit Insurance Corporation and is regularly examined by these agencies.

(e) First Security Bank, Rock Springs, Wyoming, a Wyoming state bank with deposits of approximately \$3,000,000 to \$5,000,000 and approximately 2,000 depositors. First Security Corporation acquired this bank in 1928. This bank is subject to supervision, inspection and control by the Wyoming State Board of Banking Examiners and Federal Deposit Insurance Corporation, and is regularly examined by these agencies.

(f) Western Investment Corporation, an Idaho corporation holding various assets. The First Security Corporation acquired this company in 1931.

(g) Security Savings and Loan Association, a Utah state savings and loan association, with approximately \$30,000,000 to \$46,000,000 in deposits. The First Security Corporation organized this savings and loan association in 1954. This association is supervised by the Utah State Banking Department and regularly examined by this agency.

(h) First Security Savings and Loan Association, an Idaho state savings and loan association, with approximately \$2,000,000 to \$10,500,000 in deposits. This associa-



tion is supervised and controlled by the Home Loan Bank Board and the Idaho State Commission of Finance, and regularly examined by these agencies.

9. From 1948 through 1952, First Security Banks had available for their customers group credit, life, health, and accident insurance written by the Credit Life Insurance Company of Springfield, Ohio. Smith was designated as agent for Credit Life pursuant to an agency agreement between Smith and Credit Life, and commissions were paid by Credit Life during this time.

10. From January 1, 1953, through April 1, 1954, First Security Banks had available for those borrowing from them group credit life and group health and accident insurance written by the American Bankers Life Insurance Company of Florida. Smith was designated as agent for Bankers Life pursuant to an agency agreement between Smith and Bankers Life.

11. Before 1953, Credit Life paid commissions pursuant to its agency agreement with Smith. During 1953 and early 1954, the net premium, after deducting the commission, was remitted each month to Bankers Life.

12. Petitioner First Security Company reported the commissions and expense reimbursement payable to Smith from Credit Life and Bankers Life as income on its federal income tax returns.

13. From January 1, 1955, to December 31, 1959, Smith and Agency, Inc. were designated as agents for ANICO with respect to excess line insurance (i.e., insurance purchased by bank customers in excess of the coverage authorized by the group policies identified below).

14. Prior to and during the years in suit, the First Security Company, which provided a uniform system of accounting and performed similar services for the First Security Banks and other subsidiaries of the First Security Corporation, collected and transmitted life insurance premiums and reports to ANICO and other insurance companies.

23. Attached hereto are copies of the following documents:

Exhibits:

A-1 Income tax returns filed by First Security Bank of Utah for the years 1954 through 1959;

B-2 Income tax returns filed by the First Security Bank of Idaho for the years 1954 through 1959;

C-3 Income tax returns filed by the First Security Company for the years 195 [5] through 1959;

D-4 Credit Life Insurance Company policy No. 51710;

E-5 Credit Life Insurance Company policy No. 51961;

F-6 Agency agreement 1472;

G-7 Agency agreement 1472-A;

H-8 Specimen of Credit Life Insurance Co. application for credit life insurance;

I-9 Bankers Life group life insurance application dated 1-6-53;

J-10 American Bankers Life Assurance group life policy No. 1002;

K-11 Agency agreement between Smith and American Bankers Life dated 8-30-52;

M-13 Bankers Life Insurance Agency Agreement (with Kirk Landon) dated April 6, 1950;

N-14 American National group life policy No. 3405, and riders;

O-15 American National group life policy No. 4-3406, and riders;

P-16 Reinsurance Treaty effective April 1, 1954, with Amendments effective April 1, 1956 and August 1, 1955;

Q-17 Reinsurance Treaty No. 1 with Amendments effective Sept. 18, 1959, and January 1, 1960;

R-18 Reinsurance Treaty No. 2, effective Dec. 1, 1958, with Amendments effective Sept. 18, 1959 and Jan. 1, 1960;

S-19 American National group policy No. 8-5038;

T-20 Reinsurance Treaty effective Feb. 1, 1955, together with Amendments #1 and #2; and reinsurance treaty executed on April 22, 1957, and amendments dated Sept. 18, 1959;

U-21 American National group policy No. 1-3405, together with riders effective April 15, 1958, and January 1, 1956;

V-22 American National group policy No. 1-3406, together with riders;

W-23 Reinsurance Treaty effective January 1, 1956;

X-24 American National Insurance Co. group life policies No. 1-1956-003-004; and No. 1-1956-003-003;

Y-25 Reinsurance Treaty effective March 20, 1959, with Amendment effective Sept. 1, 1959;

Z-26 Agent's Agreements dated January 1, 1955 between American National and Agency, Inc.;

AA-27 Agent's Agreement dated January 1, 1955, between American National and Smith;

AC-28 Sample of insurance certificate issued by American National on policy No. 1-1956-003;

AD-29 Sample of American National Insurance certificate issued with respect to Insured Savings Account;

AE-30 Sample of American National Ins. Co. Excess Coverage certificate;

AF-31 Sample of American National Insurance Co. Life & Disability certificate (Idaho);

AG-32 Sample of American National Ins. Co. Life & Disability certificate (Utah);

AH-33 Sample of American National Ins. Co. Excess Coverage-Life & Disability;

AW-36 Minutes of the Regular Meeting Board of Directors, First Security Corp., 7/28/48;

BE-37 First page of Minutes of Meeting of Executive Committee First Security Corp., 4/1/54;

BG-39 Minutes of Meeting of Executive Committee, First Security Corp., June 8, 1956;

BO-40 Annual statements, or portions thereof, of First Security Life Insurance Co. of Texas;

BR-41 Income tax returns filed with the District Director, Internal Revenue Service, Dallas, Texas, by First Security Life Ins. Co. of Texas;

BS-42 A schedule showing the officers and directors of First Security Corporation and subsidiary corporations during the years 1954 through 1959;

BT-43 Articles of incorporation of Security Life, Smith and Agency, Inc.

44 Schedule setting forth the percentage of petitioner bank customers purchasing credit insurance during the years in issue;

BV-45 Schedule showing amount of commissions paid on sales of credit insurance by petitioner banks before 1954, and reported as income by the First Security Company;

BW-46 Copies of custodial arrangements between Security Life and petitioner banks;

BX-47 Copy of Security Life's 1957 state of California franchise tax return, bank statements, deposit slips and stationery;

CC-48 Copies of the statutory notices issued to each petitioner;

CF-49 Copy of government Bond Letter No. 406, dated March 31, 1943;

CG-50 Copy of extract from minutes of the meeting of the Investment Committee of the First Security System of Banks, dated April 20, 1953;

BZ-51 Schedules setting forth the following information taken from the books and records of ANICO and Security Life concerning the sales of credit insurance pursuant to the group policies listed above.

(1) Premiums ceded, claims and claims' expenses with respect to sales of credit life, accident and health, mortgage, twin dollar savings and borrow-by-check insurance.

(2) Total gross written premium, gross written premium attributable to sales of credit insurance to customers of each petitioner-bank; gross earned premium retention by American National net premiums ceded; claims attributable to insurance sold to customers of each petitioner bank.

[(3)] \*

C. PRESTON ALLEN  
*Counsel for Petitioners*

LESTER R. URETZ [MLS]  
*Chief Counsel*

Internal Revenue Service

[\* Further and more expanded financial data relative to subjects described in (1) and (2) above.] [JB]

Filed February 8, 1967.



## TAX COURT OF THE UNITED STATES

[Caption Omitted]

## TRANSCRIPT OF PROCEEDINGS

## APPEARANCES:

[5] ALONZO W. WATSON, JR., C. PRESTON ALLEN and STEPHEN H. ANDERSON, ESQS., (RAY, QUINNEY & NEBEKER), appearing on behalf of Petitioners;

JAMES BOOHER, Esq., Internal Revenue Service, appearing on behalf of Respondent.

## [22] OPENING STATEMENT ON BEHALF OF RESPONDENT

By MR. BOOHER

[26] Respondent's position is that the reinsurance premiums paid by American National to Security Life were excessive. They were more than the amount needed to defray expected mortality costs or other expenses attributed to the business, and allow a reasonable profit for underwriting and carrying the insurance risks.

The excess part of the reinsurance premiums is a commission or rebate earned by Petitioner banks whose lending business generated the sale of insurance, and who controlled the placement of this insurance with American National.

[28] Petitioner banks, as I understand it, contend that the provisions of Title 12, USCA 92, prohibit the receipt of any income from the sales of credit insurance. In several prior cases we realize that the courts have refused to attribute income from the sales of credit or other forms of insurance to a lending entity where a State law generally prohibited the lending entity from acting as an insurance agent.

## [COLLOQUY BETWEEN COURT AND COUNSEL]

[48] THE COURT: I don't think there is any question about the fact that the corporation or individual has a right to—

they would be foolish not to look at the tax consequences of everything they do.

So I think that perhaps Petitioner would admit that every action they take, they look to see what the tax effect is.

MR. BOOHER: They haven't done so thus far.

MR. ANDERSON: We stipulate that it would be a misfeasance of a corporate officer not to be aware of tax effects of his corporation actions.

[49] THE COURT: I should certainly think so. I know if I were on the Board of Directors of a corporation, every action we do I would have counsel in there to tell me what the tax effect would be.

. . . . .

[54] THE COURT: I am going to admit them in evidence, but I don't think you can prove your case through these at all. I am not going to give them any weight.

At the present time I don't see that I can give any weight to this kind of argument. However, they are received into evidence, both of those letters, A-Q and A-R, A-Q having been marked for identification.

. . . . .

[79] MR. ANDERSON: The Petitioner calls Larry Harlan to the stand.

W. LARRY HARLAN

was called as a witness on behalf of the petitioners and, having been first duly sworn, testified as follows:

THE CLERK: For the record, may we have your name?

THE WITNESS: W. Larry Harlan, H-a-r-l-a-n.

THE CLERK: Your address, please, sir?

THE WITNESS: 9963 Rockbrook Drive, Dallas, Texas.

#### DIRECT EXAMINATION

By MR. ANDERSON:

Q. What is your business, sir?

A. Insurance.

Q. What company are you associated with?

A. American National Insurance Company.

Q. Incorporated where?

A. Galveston, Texas.

Q. Would you review for the Court the years that you have been in the insurance business and generally what you did in the insurance business?

A. I almost have to tell my age.

I started in the insurance business in 1921 with the rate book at Salina, Kansas.

Two years later I was State Aide of Midwest Life, Lincoln, Nebraska.

[80] In 1927, I became superintendent of agencies of the National Insurance Company. Now they call this job agency vice-president.

In 1938, I took over the credit life of the division of the Reserve Long Life Insurance Company of Dallas, Texas.

On October 1, 1949, the Reserve Long Life Insurance Company sold this division to the American National Insurance Company of Galveston, Texas, and since that time I have been manager of the credit life division of the American National Insurance Company, and our operation and headquarters are at Dallas, Texas.

Q. For 30 years now you have been manager of the credit life division of American National; is that right? Is that what you said just now?

A. Or the division before American National was with Reserve Long Life.

Q. How big is American National?

A. American National Insurance Company is I believe the seventh largest stock life insurance company in the United States, with insurance in force in excess of \$9 billion, and with total assets in excess of one billion three hundred million, and with capital and surplus funds in excess of \$250 million.

The credit insurance division of American National as of December 31st has \$1,681 million of credit life insurance [81] in force.

We operate in every state with the exception of the state of New York.

Q. That was my next question.

Does an operation like this take considerable personnel or not?

A. Yes, it does. And maybe this is something we shouldn't talk about. We have very definite ideas as to how credit insurance should be operated in the public interest.

Q. I didn't mean to cut you off.

However, to finish your qualifications out, are you a member of any committees?

A. Yes, I have been a member of the credit insurance committee of the Health Insurance Association of America for a number of years.

I am also a member of the credit insurance committee of the American Investment Bankers of America.

I formerly had other assignments which I now delegated to the general counsel of our division of the company.

Incidentally, he is co-chairman of a morbidity study right at the present time with Yates of the Metropolitan, working in conjunction with the National Association of Insurance Commissioners.

Q. Are you supervising your counsel?

[82] A. Yes.

Q. For the last 20 years have you been on various committees working with the National Association of Insurance Commissioners?

A. I started with the original meetings of the NAIC, studying proposals for the present so-called model credit life insurance bill that is now in force in I believe 38 states and have been very active in helping getting this bill implemented in all the states of the United States, and as a result, for the past 20 years I have been working in some capacity with committees, working in conjunction with various segments of the National Association of Insurance Commissioners.

Q. Is there anything about the credit life insurance business, any material element of it, that you haven't made yourself familiar with in the last 30 years?

A. Credit life insurance business has grown very fast. It has come a long ways in the last ten to 12 years. There are new problems coming up all the time.

Q. Are you generally acquainted with the various aspects of credit life? I don't mean to spend too much of the Court's time on your qualifications. I just want the Court to be aware of your expertise in general.

A. At times we do make mistakes, Your Honor, and I have a beauty that I made in the state of California that [83] cost American National Insurance Company money.

We research this business very thoroughly, but we cannot be right all the time.

Q. During the years 1954 through 1959, was any officers or directors of the First Security Corporation, the First



Security Bank of Utah, the First Security Bank of Idaho, or the First Security Company, of those groups, were any officers or directors of those corporations officers or directors of the American National Life Insurance Company?

A. No, sir.

Q. Was this company an independent, completely independent and separate from the First Security Corporation?

A. Yes, sir.

MR. ANDERSON: Your Honor, to save time, in the local finance case to which we have alluded previously at the pre-trial conference, the Government stipulated to a number of general background facts, non-controversial I am sure, which we haven't really had time to stipulate together now.

So, to give Mr. Booher a chance to cross-examine on this, and yet to save time, I would like to read what I consider to be necessary background information for the record, and ask Mr. Harlan if this is correct, and then Mr. Booher can cross-examine if he so desires.

Would that be acceptable to the Court?

THE COURT: Any objection?

[84] MR. BOOHER: No.

THE COURT: You may proceed, Mr. Anderson.

By MR. ANDERSON:

Q. "Credit Life Insurance, insofar as pertinent herein, means single premium term insurance on the life of a debtor with his creditor designated as first beneficiary in an amount at least sufficient to discharge his indebtedness in case of the debtor's death.

"The growth of the credit life insurance has paralleled the growth of the consumer credit, and in the United States most consumer credit is now covered by some form of credit life insurance.

"It is estimated that about 50 million people in the United States are covered by some form of credit life insurance, and the total face amount of such insurance now in force is in excess of \$49 billion.

"Credit life insurance is sold usually as an incident to more prominent transaction, namely, a loan of money or installment sale of tangible personal property. It provides a sure, quick and uncomplicated means of liquidating the balance due on the loan or installment sale in the event of

the death of the borrower or purchaser, and to the extent of the benefit paid-extinguishes the debt.

"Credit life insurance is written in two different ways. One, under an individual insurance policy issued [85] directly to the insured debtor or, two, under a group policy in which case the beneficiary creditor is the policy holder and the individual insured debtor receives a certificate of insurance.

"The insurance involved in these cases was written on the lives of debtors of the petitioner banks for a term which was co-extensive with the contractual term of the related indebtedness.

"Two plans of life insurance coverage are most generally provided by credit life insurance, namely, one, decreasing term coverage, also called the planning balance insurance, under which the amount of the death benefit decreases during the policy term coincidentally with the decrease under the amount of the debt under the applicable installment payment: and, two, level term coverage under which the amount of the death benefit remains constant during the policy term, a type of coverage particularly suitable where the debt is not payable in regular installments-but, for example, in a lump sum.

"For the years here involved and since January—or April 1 of 1954, the bulk, the majority of the credit life insurance issued to the debtors of the First Security Banks was individual, single-premium, decreasing term life insurance under a group policy, issued to the bank."

That is, the debtors received certificates when they [86] took out insurance.

"During this period of time, and since January 1954, a certificate evidencing this insurance was issued to each of such debtors purchasing the policy.

"Under a normal credit life insurance policy, the creditor is the primary beneficiary to the extent of the unpaid balance of the indebtedness at the time of the insured's death.

"If because of prepayment or some other reason the amount of the death payment payable under the policy should exceed the balance due on the account, the insured's designated secondary beneficiary receives the excess. Such provisions were applicable to the insurance coverage obtained by borrowers from Petitioner banks herein.

"The premium due for the entire term of the insurance

company on the lives of the debtors of the Petitioner banks was paid in a lump sum at the inception of the coverage.

"In the event the loan was paid off in advance, in some instances the insurance was terminated and a refund of the premium allocable to the unexpired portion of the old loan was made."

That is, Your Honor, whenever a loan ceased to be outstanding and there is still insurance coverage in force, there would be a refund where appropriate, or if there was a cancellation there would be a refund where appropriate. [87] "If the loan was refinanced by a new loan and new life insurance was written on the new loan, the insurance on the old loan was always terminated and the premium allocable to the unexpired portion of the old one was refunded or credited to the premium on the new insurance.

"During the years here involved and since April 1954, the premium charged by the American National Life Insurance Company to the Petitioner banks' debtors was one dollar per \$100 coverage per year on decreasing term insurance. This rate was the rate commonly charged in the credit life industry in Utah, Idaho and in Texas, the states involved in this suit all during the years in suit."

Is what I have just read correct, sir?

A. Would you read me the first paragraph again?

Q. The very first paragraph?

A. Yes.

Q. "Credit life insurance, insofar as pertinent herein, means single premium term insurance on the life of a debtor with his creditor designated as first beneficiary in an amount at least sufficient to discharge his indebtedness in case of the debtor's death."

A. We had one type of coverage in the First Security Banks, and this was this double-dollar savings that was on monthly outstanding balance.

Now, on all the insurance written on debtors, it was [88] all single-premium.

Q. With that change, would what I have just read be correct?

A. Yes.

Q. Tell the Court what led to your initial contacts with the First Security Corporation, what those contacts were and what came out of those contacts, as briefly as possible, would you, please?

A. Well, it all went back to the summer of 1953, attending

a midyear meeting of the American Finance Conference in New York City.

And the chief topic on the floor of the members was why did CIT organize Patriot Life Insurance Company of New York.

Well, when CIT had organized Patriot Life I happened to have been familiar when Occidental Life was organized in this state, and I had some friends who wrote some of the first life insurance policies with Occidental Life with the cooperation of the managers of the Bank of America.

So what I am saying is that where any firm has lots of debtors, doing business with lots of people, these are very good prospects for life insurance.

Of course, at that time the laws were very favorable, tax laws, to a life insurance company as well, but some of the main things are that if you are successful in building a [89] life insurance company, you have that terrific premium income available for investment.

So I came back home, and I talked to our management.

I said, "We have got to make up our minds. Unless we can come up with some idea, we might as well forget all of our big credit life accounts because I think the handwriting is on the wall, they are going to start organizing their own life insurance companies."

So, making use of our various departments, our legal departments, our actuarial department, and what-not, we came up with an idea and the idea was this: We went to our big clients, and we said, "Look, if you want to develop a life insurance company we will make the brains of the manpower of the American National Insurance Company available to you to aid and assist you to build this company."

And as a result, today we are operating the books and advising and counseling with people that own in excess of 60 life insurance companies, and we added more new life insurance companies to this group last year than any previous year since it started in December 1953.

Do I need to say—

Q. What happened when you went to First Security Corporation with this idea?

A. I had been trying to do business with First Security Corporation for several years, and they were doing business [90] with other companies.

One of the first banks in the West that came with us



was the Valley National Bank of Phoenix. They came with us in December of 1963. Naturally we called on other outstanding banks in the area, and the First Security Corporation was on the list.

I talked to Mr. Owens Thurman, who in turn took me to Mr. George Eccles, and I told Mr. Eccles why I thought it was to the interest of their organization as to the ownership of a life insurance company.

Q. Tell the Court how long the corporation considered what you told them before they took any action.

A. I think it was probably a six-month period.

Q. Did the spring of 1963—strike that.

Was it from the spring of 1953 until April 1st of 1954?

A. No, I didn't say the spring of 1953. I think probably the first time that I talked was either the fall of 1953 or after the first of January of 1954.

THE COURT: Then what action was taken?

THE WITNESS: They decided to organize the life insurance company. They decided to make use of the personnel of American National Insurance Company to operate the life insurance company for them.

[91] By MR. ANDERSON: /

Q. Was a life insurance company then formed?

A. Yes.

Q. Was that the First Life Insurance Company of Texas that we are talking about in this suit?

A. Yes, sir.

Q. Was that corporation submitted at its inception for approval to the insurance commissioners of the state of Texas, or reviewed by them at the end of that year?

A. Number one, you have to get the approval of the Board of Insurance Commissioners before you get a charter granted. After the company, it was activated, then—back in those days, under the Texas laws, it had to be examined at least once every two years, and it was so examined.

Q. Has there been any criticism from these examinations?

A. To the best of my knowledge we have never had criticism on the operation of any of the companies. Also, we operate for clients on this program.

Q. Do you file annual statements for the Security Life of Texas with the Texas Insurance Commissioners?

A. Yes.

Q. All during the years 1954 through 1959, was that correct?

A. Yes.

Q. Tell the Court if there is any difference between [92] having a life insurance company and having a life insurance agency.

A. Well—

Q. Are they the same thing?

A. There is no comparison at all. A life insurance company is taking a risk every time they issue an insurance contract, or if they enter a reinsurance treaty from some other company that has issued the risk.

An agency has to be, of course, licensed by the proper State authorities, and it has contracts to go out and offer insurance for sale on a commission basis. And so the income of the agency is totally based upon their ability to sell insurance under the terms of the agency contract they have with a life insurance company, whereas a life insurance company, its source of earnings are from underwriting profits, if they are smart in selecting risks.

And if they are smart in making—or investing profits.

Q. Is there any guarantee that a life insurance company is going to make a big profit?

MR. BOOHER: I object to that as being argumentative.

MR. ANDERSON: I withdraw the question.

By MR. ANDERSON:

Q. What kind of profit would a life insurance company expect to make?

[93] MR. BOOHER: If this is relevant to this case, I suggest that it would be more specific so that answer would be more relevant to a company of the type similar to the ones that are in issue in this case.

By MR. ANDERSON:

Q. In 1954, what kind of profit would Security Life of Texas expect to make, big, little, or medium?

A. In the first year of its operation, it was problematical whether it would make any money at all.

Q. Was there any way of telling whether it would make money or lose money?

A. No, sir.

Q. Under the life insurance policies issued by American National Life Insurance Company during the years 1954 through 1959, these group policies we are talking about which are in evidence, was there any legal relationship between American National Life Insurance Company and the policyholder?

A. The policies were written, and the policyholder was a policyholder of American National Insurance.

Q. Who would the policyholder look to?

A. American National.

Q. Was there any obligation from Security Life to American National under the insurance?

A. Security Life would have to reimburse American National for all claims paid.

[94] Now, if by any chance Security Life did have the funds, American National would still have to honor the policy, the terms of the policy contract.

Q. If for some reason Security Life of Texas refused to pay on claims submitted by you, would you consider suing them to get those claims?

A. I would sue them.

Q. Security Life of Texas, as shown by exhibits in evidence, received 85 percent of the standard rate charged, that is, these premiums, less cancellations, as its payment for insuring a hundred percent of the risk.

Now, in your expert opinion, did Security Life of Texas need that amount to operate on a sound basis?

A. I think I have already answered your question. I told you it would.

Q. It would?

A. Yes.

Q. About what margin—

A. May I say this. I have some companies that have attempted to pay some commissions in the past 12 months, and without exception we have had to call upon them to contribute additional surplus.

Q. Very well. The Judge has heard how big American National Life Insurance Company is. About what margin of profit does your company operate on?

[95] A. Less than five percent.

Q. Did Security Life Insurance Company of Texas have that volume of business to stay on a sound basis?

A. No, they don't have sufficient volume of business.

Q. Is there any financial similarity between the two companies, any comparison?

A. There is all the difference in the world between a small country grocery store and a big super market, and you have got the same thing here, Your Honor.

Q. During the years 1954 through 1959, was it the exception or the rule to have reinsurance companies like Security Life operating in the financial world in the business of finance?

MR. BOOHER: Object to that as being argumentative. If we are to show the practices, what the practices were, we should have more definite information in the form of statistics.

MR. ANDERSON: What the Government is trying to do here is put us into an unusual situation. I want to erase from the record that what we are doing is unusual, rare or strange.

THE COURT: He may answer.

By MR. ANDERSON:

Q. Will you answer, sir?

A. With the exception of the largest finance company of the United States, practically every other company of any [96] size owns a life insurance company, and some own more than one life insurance company, such as Commercial Credit.

Q. Did the Credit life insurance business operate on a volume basis, still being comparatively young in 1954?

A. Yes.

Q. Were rate losses fixed and known at that time?

A. Would you want me to enlarge upon that?

Q. Yes, briefly.

A. The credit insurance business is a new business. It wasn't too many years ago that we had very few laws regulating the credit insurance business, Your Honor. It was unusual for a creditor to buy insurance wholesale, and then charge as much as he could for it.

In fact, some of our great big banks charge two and a half times the cost of the insurance, and these things are on record.

There were cases when in the event of refinance, prepayment, they never cancelled the insurance. There were cases—we had one case in Austin, Texas, where a little

insurance company sold policies for 12 and a half cents apiece with the understanding there would never be a claim.

Q. Summarize.

A. This is what brought together people working with the insurance commissioners, and this is where the medical credit life bill came into being, which is now being passed by 38 [97] states, and included other states this year.

Q. Were loss ratios and rates fixed and known at that time?

A. Loss ratios ten years ago were absolutely meaningless.

Q. Do mortality rates vary in the credit life business?

A. Definitely.

Q. There is no one set percentage of mortality?

A. I wish there was a book that could give us an answer. There isn't.

Q. On the business that American National was involved in with the First Security Corporation, the Petitioner banks, and Security Life of Texas, during these years in suit, were there any health requirements for the people who got the insurance?

A. No, sir. Even though the man maybe had cancer, if the insurance was issued we made the claim when he died.

Q. Was there any waiting period before the insurance went in force?

A. None. We are trying to clear this up in the industry, Your Honor, right now.

Q. Would this situation have any effect on mortality rates?

A. Certainly.

Q. Bad or good?

[98] A. If you write a very restrictive cover—

Q. You didn't understand. Does the situation of not having health requirements, not having waiting periods, affect the—

A. Certainly, your loss ratios are much more.

Q. Could Security Life have begun alone as a full-line direct writer on the capital it had?

A. Impossible.

Q. Was it possible to use managerial service, the managerial service of American National, as to all of the personnel, in order to operate on a sound basis?

A. Or some other.

Q. Could Security Life have duplicated services offered



by American National, that is, staff its own office and get its own actuaries, and for the same amount of money that it paid American National to perform those same services?

A. To attempt to staff their own company would have cost more than 50 percent of the annual premium that was originated in the first year or two.

THE COURT: Then your answer was no?

THE WITNESS: Yes, no, Your Honor.

By ANDERSON:

Q. Well, my next question would have been how much more would it have cost, and you have answered that.

Is it common and accepted for a direct writing [99] insurance company to start out as a reinsurance company like Security Life of Texas?

A. There have been a number of cases, yes. In fact, we have some cases where companies that started out as reinsurance companies are now writing life insurance direct.

Q. Have you had conversations with the officers of First Security Corporation during the period of your first contact with them on, and have they had conversations with you about the expansion of the First Security Life Insurance Company of Texas?

A. This was talked about in our first interview, and it has been talked repeatedly ever since.

Q. That is the expansion into whole direct line writing?

A. Expansion of First Security Life into all phases of life and casualty insurance writing.

Q. Just a couple of more questions.

During the years 1954 through 1959, did American National have any contract of any sort, of any shape or nature, with the First Security Company, the management company?

A. No.

Q. Did it have any contract or agreement of any sort with the employees of First Security Company?

A. No, sir.

Q. Other than the group policies in this suit, did [100] American National have any agency agreements or contracts, or any other agreements of any sort, with the Petitioner banks in this case?

A. No, sir.



Q. Or the employees of those banks?

A. No, sir.

Q. Was there any legal connection at all between American National Life Insurance Company and the First Security Company, or the First Security Banks of Utah and Idaho, other than the group policies on the banks?

A. No, sir.

Q. Can just anyone form a company like First Security Life?

A. No, sir.

Q. Would you, as an associate of American National, allow your management services to be purchased by just anybody, forming your national company?

A. We have said no to a number of people, coming to us because they did not meet our requirements.

Q. How would you say that American National's management services compare with other large life underwriting companies?

A. You shouldn't ask me that, because I would be prejudiced.

Q. Can we agree that you think they are superior?

[101] A. As long as our clients think they are, that is all I am concerned with.

Q. The Government in this case is suggesting that part of the money which Security Life got in the years 1954 through 1959 was some sort of commission.

Do you know of any law or regulation or practice in the insurance business which dictates that a certain part of the premium rate is or must be a commission?

A. There is no such law that I know of.

Q. Is there any standard commission in the insurance industry out of every premium rate?

A. No.

Q. Do commissions and rates vary throughout the industry?

A. Yes, sir.

MR. ANDERSON: That is all I have. You may cross-examine.

THE COURT: Cross-examination?

MR. BOOHER: No questions, Your Honor.

THE COURT: Thank you very much, MR. HARLAN. You may be excused, and you can step down, sir.

(Witness excused.)

[116] MR. WATSON: Your Honor, Petitioners would like to call as their next witness, Mr. George S. Eccles.

GEORGE S. ECCLES

was called as a witness on behalf of the Petitioners, and, having been first duly sworn, testified as follows:

THE COURT: For the record, sir, may we have your name?

THE WITNESS: George S. Eccles, E-c-c-l-e-s.

THE CLERK: Your address, please?

THE WITNESS: 1525 Penrose Drive, P-e-n-r-o-s-e, Salt Lake City, Utah.

DIRECT EXAMINATION

By MR. WATSON:

Q. Mr. Eccles, you are an officer and/or a director of [117] each of the Petitioner companies in this case; is that not correct?

A. I am.

Q. And you were during the years 1954 through 1959 an officer and/or a director of each of these Petitioners?

A. Yes.

Q. And are you also an officer and director of the First Security Corporation?

A. Yes.

Q. And were you an officer and a director of First Security Corporation during the years 1954 through 1959?

A. Yes, sir.

Q. Would you explain the relationship between the three Petitioner corporations and the First Security Corporation?

A. That's the two banks and the holding company; is that right?

Q. The two banks and the management company?

A. First Security Corporation—

THE COURT: For the record, the management company is the First Security Company—or corporation?

MR. WATSON: No. The management company is the First Security Company.

THE COURT: Right.

By MR. WATSON:

Q. Shorten it this way, and let me ask you directly, [118] are the three Petitioner companies subsidiaries of the First Security Corporation?

A. They are.

THE COURT: That's better.

By MR. WATSON:

Q. Give a short description of the history of the First Security Corporation.

A. The First Security Corporation is a bond holding company qualified now under the banking Act of 1956 as a registered bank holding company.

The First Security Corporation was organized in 1928 or '29 and the banks mentioned are subsidiaries of the First Security Corporation.

The First Security Company is a service corporation rendering service to the banks and a wholly owned subsidiary of the First Security Corporation.

The First Security Corporation is a Delaware corporation.

It is not even qualified to do business in Utah because it is particularly a holding company of the stock of the two banks and the First Security Company, along with other subsidiaries.

Q. Give us a little history of the development of the First Security Corporation?

A. The First Security Corporation is the oldest bank [119] holding company in existence, recognized by the comptroller of the currency in his annual report to the Congress of 1928.

At that time there was a group of banks owned by the people that started First Security Corporation and we put them all into one corporate entity, took stock—the owners of those banks took stock in the holding company.

We started out with about, oh, a very few banks and then in '33 you had a branch banking legislation passed in Utah and Idaho and the independent banks were thrown together in one branch in each state.

That was in 1933. Now, the subsidiaries, consists of four banks with 101 banking offices, extending from the Canadian border through to the Arizona border throughout

Utah and Idaho and one independent bank in Rock Springs, Wyoming.

Q. In these early years from 1954 through 1959, did the First Security Corporation also have other non-banking affiliates?

A. Yes. They had savings and loans. They had the Company, Ed. D. Smith, which was an insurance agency, having been the general agents for Aetna Casualty Company for over 20 years.

I think during those years we acquired First Security Insurance agency of Idaho in conjunction with acquiring a bank in Idaho sometime during that period.

Q. Let me ask you this.

[120] What was the attitude inside the corporation?

Was the corporation expanding its operations all of the time?

A. Very definitely.

We organized during that same period a Security Savings and Loan with five offices, three in Idaho and two in Utah.

We endeavored to acquire other types of financial operations.

We were desirous of having—of going into the life insurance business.

Well, we are desiring of expanding any way we could under a central holding company that had sufficient financial base to go into all types of the financing field.

Q. What is the management's structure of First Security Corporation? How is it operated? Through what—

A. The First Security Corporation, the parent holding company, has had from 25 to 30 directors during its entire existence, very representative directors of industry and finance.

They meet quarterly. The First Security Corporation through its Board of Directors is—has appointed an executive committee with power to act between board meetings.

They act for the board and any legal actions taken by the executive committee is reported to the board at the [121] quarterly meeting for board approval.

The executive committee also meets in an informal capacity oftener than they do in the so-called legal capacity and then it is somewhat of a policy type board.

The minutes are not—they don't go into the general—I mean, the minutes, they are merely memorandums is all they are.



Q. Has the corporation also attempted to obtain as members of its board, outstanding men in business and finance in the inter-mountain area?

A. Well, not only the inter-mountain area, because our influence, we feel, goes beyond the inter-mountain area.

We participate in national company credit lines and that and so we expand our board very much.

Today, for example, we have and have had the president of Union Pacific, headquartered at Omaha; the president of the Rio Grande and Denver Railroad; we have the presidents of two of the largest lumber and plywood and paper companies which includes the president of Potlatch Forest, one of the largest lumber and paper companies in the country.

They have a huge mill in Lewiston, Idaho, but his headquarters are in San Francisco.

We have the head of the Boise Cascade. That is one of the national companies, one of the large ones in lumber and paper, the lumber and paper industry.

[122] Their headquarters are Boise, Idaho. We have the president of Utah Construction Company and his headquarters are in San Francisco.

We have the head of the Utah Copper Company—I don't mean that. I mean the Utah Power and Light Company. We did have the head of the Utah Copper Company at that time.

Q. During these years 1954 through 1959, you had similarly representative men?

A. All of the time, ever since it started.

Q. Would you explain to the Court how your boards of the two banks are constituted?

A. The legal board of directors of the two banks is made up of the senior officers of the two banks, not overlapping, except in my particular case.

I happen to be on the board of the Idaho bank and the board of the Utah bank.

We have senior officers of the banks and the member of the executive committee of the First Security Corporation on the Utah board.

Then we have a board that we call an advisory board in the Utah picture. They consist of representatives citizens and would act as the same as a Board of Directors of any other bank, but being a branch system, you don't take a day or two of their time to go over all the matters in the branches of the four corners of the state.



[123] You do that legally under the National Bank Law. That is, you do that through your official Board of Directors. But, as to Salt Lake and Ogden and the major parts not only go to this board of directors but go to this advisory board.

Many of those advisory board members are also directors of the First Security Corporation.

Q. Does a director of a national bank have any special obligations or duties?

A. I would think very definitely he does. It is set forth in the National Banking Law. It is very detailed and you have very grave responsibilities.

Q. Could you name some of these restrictions?

A. Well, you are required to approve the loans that are put on by your loan officers, identify them by number, review them once a month.

You are required to have a member of your board as chairman of your trust committee or your trust department.

You are required to own, unpledged, just a normal amount of stock, but that is one of the requirements of the law.

You are responsible for the soundness, the proper operation of the banking institution. And if you violate any provisions of the law, of the banking law, it sets forth very grave penalties and not only that, but it gives the right of the banking authorities to ask for your removal.

[124] Q. Mr. Eccles, are you now on the comptroller's advisory staff?

A. I am and have been since Mr. Saxson set it up.

Q. During your years as a bank officer and bank president, have you worked closely with National Banking Associations?

A. Very definitely.

I have held many positions with the American Bankers Association, all through the years. I have been head of their economic research department. I have been a member of the legislative committee.

I have been a member of their economic educational group.

I have been a member of the Reserve City Bankers Association which is an inner group made up of the 200 largest banks, representatives from those banks.

They happen to be the senior officers. In fact, I am the oldest member in years of service of that organization.

There are about 350 members. I have chairmaned four committees during the period I have been in there.

I have been in since 1926. I have been vice-president and I have been president of it. I have been chairman of the Credit Policy Committee and I have been chairman of—and now am a member of their legislative committee.

Q. In connection with your banking interests, have you [125] also made studies in different foreign countries?

A. The year I was president of the Reserve City Bankers Association, the president of American Bankers Association and I made a trip through South America, meeting with the different bankers of those countries, studying the economic and the banking picture of the various South American countries.

The American Banking Association have promoted for 11 years—I was one of the original members of this group and am still a member, what they call the A.B.A. International Monetary Conference.

We meet in the states one year. We meet abroad one year. We have the heads of the central banks of Europe.

We have about 35 of the top leading banks in the United States representative senior officers. And two or three years ago I was general chairman of the conference in Vienna, Austria.

This year I am chairing the second day's session of that particular meeting which will be held in California in April.

Q. Are you an officer and director of First Security Life Insurance Company?

A. I am.

Q. Were you an officer and director of that company during the years 1954 through 1959?

A. Yes.

[126] Q. Did you participate in discussions leading to the incorporation of First Security Life?

A. I did.

Q. Would you explain to the Court how—or what considerations were involved in making the decision to organize the life insurance company?

A. As I have said in my earlier testimony, we were anxious to expand the operations of the First Security Corporation through its subsidiaries.

We felt that a life insurance company was a very beneficial adjunct to our entire operation.

We felt that a full line company was very beneficial. I

had had some experience with so-called baby life companies in that I was one of the original stockholders and still am, and a director of the American Bankers Life Company of Florida.

I could see that in a general life company, properly operated, it was a very profitable type of operation and the investment in that company and the American National at a later date has proven that it is very profitable.

However, we just wanted to expand and give service of all types, financial service.

We have even tried to go into the small loan field. We have even tried to go into many other types of business.

Q. Were there ever business considerations besides the [127] life insurance, the full line direct writing insurance company business?

A. Yes. We had a very active consumer credit department and we call it Time Way. It is one of the largest in the inter-mountain area. We finance the purchase of automobiles. We finance under Title 1 FHA.

We finance personal loans, all type of consumer credit.

And along at that time it was necessary to offer the borrower a protection. We call it Credit Life. He was insured for the amount that he was borrowing on a diminishing basis as he paid back the loan, the insurance would go down.

However, if he died during the life of that loan, the loan would be paid off by the insurance that he was carrying.

Then in the mortgage field, along about that same time, and I guess it is because you got into long-term mortgages under GI and FHA programs and so on, you wrote what we call mortgage cancellation insurance.

It was a policy on the individual. It was a fixed amount of 10,000 in Utah and 5,000 in Idaho to start with because that was the state law.

However, as the mortgage was paid down to the amount of the insurance, then it became diminishing term insurance from then on out.

Q. Let me interrupt you a minute.

Did you also take into consideration such things as [128] the—

MR. BOOHER: I believe he will be leading the witness with this type of questioning.

THE COURT: Yes.

THE WITNESS: Well, I was going to continue—

THE COURT: Yes.

By MR. WATSON:

Q. Were there other considerations, if any?

A. Very definitely. I was going to get to that.

As you build up your insurance company, the insurance company is not restricted on the type of investments which it can make the accumulated assets. It may go into stock which a bank can't do.

It can go into types of bonds which a bank can't do. It can handle mortgage servicing which our company did out of California, originated mortgage there and sold them to Eastern investors and did the servicing for them over the life of the mortgage.

You might say a bank is very restricted in what it can invest in while a mortgage company is not nearly as restricted.

Q. Mr. Eccles, in your opinion, would the First Security Corporation have organized the life insurance company in 1954 if it then felt that the company would not develop into a full line direct writing company?

[129] A. Oh, we thought right from the start that we would develop into a full line company.

Q. Would you have organized it unless you thought you could have gone into a full line direct writing company?

A. Well, you wouldn't have been so anxious to start it, I know that. It is pretty hard to say—I don't think you would, no, because it wouldn't have given you the scope. You couldn't develop into the size that you had thought at the time that you had started it that you were going to be able to develop it into.

Q. Why is it that First Security Life Insurance Company has not become a full line direct writing company then?

A. Because of the bank holding company Act.

I can go back on that.

I have been active on the bank holding company group since we started in 1928 and all during the period of the '30's the late '30's, the '40's, in which there was discussions in Congress in committees on proposed bank holding company legislation.

Nothing developed until the banking Act of 1956. However, from '50 on, every time the banking currency com-

mittee of the House and the Senate would meet, they would bring up possible proposed legislation which meant separating non-banking subsidiaries from sub-banking subsidiaries of the bank holding company.

[130] So, at that time we didn't know what would be the outcome of our non-banking subsidiaries which included the First Security Life.

Also, included the Saving and Loans and so on.

Q. Were there other reasons, if any, why the life company has not developed into a full direct line insurance company?

A. I don't think so. It couldn't, under the holding company, apparently, and I—by '56 we knew we couldn't.

Q. There were no other reasons that inhibited this life insurance company?

MR. BOOHER: The witness answered the question. There were no other reasons that he knows of and this should terminate the matter.

I object.

THE COURT: Have you finished your answer?

THE WITNESS: I think I have.

THE COURT: Next question, please.

I haven't acted on your objection. Let me hear the question rephrased or get into your next question, Mr. Watson.

By MR. WATSON:

Q. I asked him if there were other reasons, if any, why the plan to create a full direct line life insurance company was not carried out?

A. May I answer that?

THE COURT: Yes. You can answer yes or no.

[131] THE WITNESS: Yes.

THE COURT: Any objection?

MR. BOOHER: I object to the question. The witness previously stated he knew of no other reasons and that should end the examination on this point.

By MR. WATSON:

Q. Have you now had an opportunity to think about it a little more?

A. Yes.

MR. BOOHER: The Court hasn't ruled.



**THE COURT:** I am going to overrule the objection and realizing at the same time that the weight that the Court would give to this next answer is judged by virtue of the way it is developed.

You may answer.

**THE WITNESS:** I don't know. I didn't think of it, but I happened to be sitting in a tax court and the reason is a tax reason. Our tax returns were still open from 1950 on.

We couldn't very well merge with whole line life companies which would be your normal means of expanding a credit life company into the whole life business because we didn't know our tax liability.

It would be hard to appraise the company, so you could arrive at a proper valuation.

We didn't know whether we were going to be considered [132] as a life insurance company.

There were many questions being raised as to whether a credit life company is a life insurance company. I understand that has been determined in some courts that they are.

The whole thing is of such a flux that you didn't know from the bank holding company Act if you could do it. You didn't know from the tax picture whether he would arrive at a valuation, so those were the reasons we sort of marked time with the First Security Life Insurance Company.

By MR. WATSON:

Q. As a result of the bank holding company Act, was it necessary for the First Security Corporation to dispose of the stock of the First Security Life Insurance Company?

Just yes or no?

**MR. BOOHER:** This is calling for a conclusion of law on the part of the witness. The bank holding company Act contains very specific statutory language, concerning what subsidiary companies may be retained by a bank holding company or must be spun off, so to speak.

**THE COURT:** The objection is sustained.

I am not precluding you to arrive at it by virtue of another or different question.

By MR. WATSON:

Q. Did the First Security Corporation, in fact, dispose of the stock of First Security Life Insurance Company?

[133] A. Well, there was a separation. It didn't go quite that way. That isn't the way it was handled, if I could explain how the split was made?

THE COURT: Yes.

By MR. WATSON:

Q. Go ahead and explain what happened.

A. The bank holding company Act in 1956 gave us a certain number of years to divest non-banking affiliates.

The Transamerican Corporation was the first one that had gone through that type of divestment.

And they had had hearings before the Federal Reserve Board which is required by the bank holding Act.

And they were required to spin off Occidental Life along with their other non-banking affiliates.

So our counsel and I went back, met with the Federal Reserve Board. They told us there was two ways in which we could do this. One would be to spin off our banks and the First Security Company which is the bank service company which is specified in the bank holding company Act is similar to a bank in being able to retain it, or we could spin off in a separate corporate entity the other companies.

However, if we did that, then we would have to go through the complete hearing.

What we did, at the suggestion of the counsel for Transamerica, our own counsel, after our discussion with the [134] Federal Reserve, we organized a new holding company. We put the banking entities and the First Security Company into the new holding company.

We distributed that to the stockholders and we retained in the first so-called old First Security Corporation, all of the other subsidiaries that we had.

Now, by splitting everything right down the line like that, the Federal Reserve didn't ask for a hearing. And had you had a hearing, you had to have a hearing on every subsidiary, not only the First Security Life, but on every subsidiary.

And they had to certify to you a spin-off before you could get a tax ruling which made the spin-off a tax free divestment, so that is the way we—then the name of the First Security Corporation was changed to First Security Investment Company and the new spin-off company carried the name First Security Corporation, owning nothing but the banking entities and the First Security Company.

Q. Then is your testimony that after——

MR. BOOHER: I will object to counsel's summarization of the witness's testimony.

THE COURT: Sustained.

By MR. WATSON:

Q. Does the First Security Investment Company now own all the stock of the First Security Life?

[135] A. Yes.

Q. Has it owned all of that stock since September of 1959?

A. Yes.

Q. Are you a member of the board of directors of the First Security Investment Company?

A. I am.

Q. And have you been since the middle of 1959?

A. Yes.

Q. And since 1959, has there been any expansion and contractions in the types of investments held by First Security Investment Company?

A. There has.

Q. Would you explain what those are?

A. Three or four years ago, we purchased the controlling interest in F.I.F., that is Financial Industrial Fund, a mutual fund management company, located in Denver, managing a mutual fund of about \$290,000,000.

We retained that for several years, but we found that during that period it was headquartered in Denver. It required a lot of extra effort and we didn't feel we were making out to that what we were justified in making and we finally sold it to the Gate Rubber people of Denver.

Then we purchased 51 per cent of Security Leasing Company, a leasing company, headquartered in Salt Lake, but [136] operating throughout the United States, having about \$15 million of leases outstanding.

We retained the majority interest in that company at the present time.

Q. In 1959——

THE COURT: I don't believe he was finished.

Were you finished with your answer?

THE WITNESS: No. The largest in New York, Aubrey, A-u-b-r-e-y, Glanston, G-l-a-n-s-t-o-n, Company deals strictly in Government bonds.

Through our various interests, we have been a small holder in that company since 1939. The owner, that is; the head of it, the one that started it, Mr. Glanston, contracted cancer, lung cancer, and knew that his time was limited, so he offered to sell to us a much larger percentage of that company, and First Security Investment Company bought that and now own it.

I am chairman of the executive committee and active in the actual operation and functioning of that Government bond house.

By MR. WATSON:

Q. Let me ask you this.

In 1959, did the First Security Life Insurance Company pay a dividend to the First Security Investment Company?

A: Yes.

[137] Q. And approximately how much—

MR. BOOHER: We will stipulate that a dividend of \$398,000 was paid during the year 1959.

THE COURT: Is that agreeable?

MR. WATSON: Yes.

By MR. WATSON:

Q. In your opinion, has there been a considerable change in the stock holdings of First Security Investment Company since 1959?

THE COURT: Let me have the question so I can rule.

Read the question back, Mr. Reporter.

(Record read.)

THE COURT: You object?

MR. BOOHER: It isn't an objection in a sense. I believe counsel mentioned in the opening statement that we don't have detail information concerning this change in ownership and so the record will be left open to get this information.

If it please the Court, I would appreciate a few minutes with—I would appreciate a few minutes recess to talk this over with counsel off the record to see what the most expeditious way is in working this out.

My understanding is that we were not going to have testimony with respect to these estimates, that we would get an actual physical count of the change in ownership.

MR. WATSON: Well, I will withdraw the question and



[138] we will leave the record open for the purpose of finding out.

THE COURT: Do you want a yes or no answer to it or do you want to skip it?

MR. WATSON: I will just withdraw it, your Honor.

THE COURT: All right.

By MR. WATSON:

Q. Mr. Eccles, in your opinion as a stockholder, director and officer of First Security Investment Company, would either First Security Investment Company or First Security Life pay over to any of the Petitioners the income which is asserted to be taxable to the Petitioners if this Court hold such income to be taxable to Petitioners or any of them?

MR. BOOHER: Before the witness answers, I will make an objection to that question.

I understand Petitioners' position to be that it is illegal for any such payment to be made.

If that is their position, then the development of that position is a matter of argument, is a question of law, and does not require any testimony from the witness.

THE COURT: Are you asking from the standpoint of a legal conclusion or his opinion as not from the legal standpoint, but from the business standpoint?

MR. WATSON: From the business standpoint as an officer and director.

[139] MR. BOOHER: If your Honor please, if his sole purpose is his business opinion, from the legal standpoint that would be irrelevant from the argument raised by Petitioners:

THE COURT: I am not so sure. I am going to let him answer from the business standpoint, but I caution you to stay away from any legal aspect of an answer.

I don't want you to say, "The law reads so and so."

If you have had meetings with your legal staff and you have been advised of thus and so and based on that, you have concluded that "we shouldn't do it from a business standpoint or other standpoints," this is all right.

THE WITNESS: The answer is yes.

By MR. WATSON:

Q. Have you discussed—



A. It would be illegal—in my business judgment, my judgment—as that I would not have them pay anything into the banking system.

MR. BOOHER: I move to strike the last answer of the witness since it involves the question of the legality of the payment.

THE COURT: It is stricken insofar as he said it would be illegal, but the rest of the answer will stand.

Have there been any meetings with your legal staff regarding this situation?

THE WITNESS: Yes.

[140] THE COURT: Has your legal staff advised you on this matter?

THE WITNESS: Yes.

THE COURT: What advice did they give you?

THE WITNESS: That it could not be done.

THE COURT: Did they advise you that it would be illegal?

THE WITNESS: In their interpretation it would be illegal.

THE COURT: This answer will stand.

By MR. WATSON:

Q. Are the First Security Bank of Utah and Idaho as national banks chartered and authorized to function under federal laws?

A. They are.

Q. Are they subject to supervision and control by federal agencies?

A. They are.

Q. What are these agencies?

A. The comptroller's office of the National Banking Division, the Federal Reserve Bank of the Federal Reserve System of which we are a member and one other on top of that, by the Federal Reserve under the terms of the bank holding company bill.

Q. Did these agencies make regular inspections?

[141] A. The National Banking Department makes the examination for both the National and the Federal Reserve and so far as the banks are concerned, the Federal Reserve makes examination of the parent holding company.

Q. What is the purpose of these examinations?

MR. BOOHER: I object. That is a statement of law.

They are making these examinations pursuant to statute duly constituted federal authorities.

THE COURT: You may be heard.

MR. WATSON: Your Honor, as an officer and director of a national bank, he certainly knows what purpose the comptroller's men make these examinations, what they are in there for, what to look at.

THE COURT: Let him state what his opinion is.

Of course, if the law is to the contrary, I will be bound by the law, not this witness's impression of what—I will let him answer.

THE WITNESS: They make two examinations a year, normally, and sometimes three in two years.

They go through your credit pouch very definitely to make sure you are complying with the requirements of the national banking law and the types of credit you make.

As to the amount, you have certain legal limit restrictions as set forth in the National Banking Act on the regulations of the comptroller. They check for that. They [142] check the credit statements to determine whether your credits are desirable assets for the bank.

They check your bond account. They check entirely through your trust department. It takes about, in our system, over a month and a half to complete the examination of either one of the two state banks.

By MR. WATSON:

Q. Well, are they looking for violations in the national banking laws?

A. Very—

MR. BOOHER: I object to that as calling for a conclusion of law.

It is also hearsay to learn what the purpose of the bank examiners are.

THE COURT: It is leading, but I will overrule the question. Obviously they are. Let us see this account and let us see that account.

I will overrule the objection, but try and watch the leading questions, counsel.

Anything that the examiners have done or any of the boards coming in to examine the banks, all of that is proper testimony.

THE WITNESS: There is one question in the examination report that asks that if we know of any violation by any officer or employee of the bank, that could have occurred

and [143] we have to certify to that and if we do know of any, we have to give a complete report.

And if we don't give it, we are hiding evidence, you might say, and we are as much liable as the guilty person, so—

By MR. WATSON:

Q. If these violations are not corrected, what can happen then?

MR. BOOHER: Again, I would object.

He is asking for an answer which involves the application and interpretation of the National Banking Laws.

It is calling for a legal conclusion. If it does not involve this, the answer would have no substance or meaning.

MR. WATSON: Again, your Honor, as a businessman and in dealing with these people regularly, he knows what—

THE COURT: I think he can ask the question, if you don't comply, are there penalties?

I think he can answer that one, but if he becomes very speculative after that—obviously there are penalties?

THE WITNESS: Yes.

THE COURT: Is there anything further you need on that?

MR. WATSON: That's all, your Honor.

THE COURT: I mean if there have been situation in the bank where the penalty was proposed by the examiners or [144] they came in and said, "Now, this is a strange transaction here and you are aware of such and such a penalty," this is proper testimony, but I don't think you can speculate as to what they might do.

THE WITNESS: This is what they do do in actual practice up to a point. From then on I have had no experience.

Any violation or any unsound banking practice, they write up in the examination report and the report is not sent to me as president of the bank. It is sent to the Board of Directors of the bank.

It sets forth very definitely. And they ask for corrections and if it isn't corrected, then they come in. And I know of one national bank institution by experience in Salt Lake City that we were not interested in, but the case is in the record and they have had many, many hearings and the Federal Reserve comes in and assists the National Department and they try to expell them from membership in the Federal Reserve and so on.

However, the San Francisco National over here was a typical example.

Here are great penalties and all you can do is try to comply a 100 per cent with your interpretation of the banking law and their directive to you as far as your interpretation goes.

THE COURT: I see.

[145] By MR. WATSON:

Q. Mr. Eccles, I show you a copy of what has been received in evidence as Petitioners' Exhibit 54 and ask you what that is, sir?

MR. BOOHER: I will object to any answer to the question. He is showing him a copy of Title 12 U.S.C.A. 92, which is a Federal Statute.

THE COURT: What does your stipulation say that Exhibit 54 is?

MR. WATSON: It has been received in evidence.

THE COURT: Yes, I know, but may I have a copy of the stipulation?

MR. BOOHER: I believe it was received in evidence to assist the Court.

THE COURT: I think it has already been stipulated that Exhibit 54 is Title 12 U.S.C.A. Section 92 and 93, relating to the power of national banks to sell insurance.

You can ask that question. It is not a leading question and it is already stipulated to and you can show him the document.

The objection is sustained with the exception of the way the Court stated it.

Now, Mr. Eccles, that is what that is?

THE WITNESS: I understand that's right.

By MR. WATSON:

[146] Q. Now, as a president of a national bank and associated with these various national banking associations, are you familiar with the provisions of these two sections?

A. I am.

That is my bible, you might say.

Q. Now, have you discussed these provisions with legal counsel?

A. I have.

Q. And have you also discussed these provisions with



various other officers and directors in the banking fraternity?

A. I have.

Q. Now, is it your understanding, based on such discussions and upon your knowledge and experience as a banker that it was illegal for banks to receive permissions or fees for services rendered in selling insurance in cities over 50,000 in population during the years 1954 through 1959?

MR. BOOHER: I object to that question as calling for legal opinion on the part of the witness.

If he bases his opinion on discussions with third parties who are not in court, it would be hearsay because the source of the information he has given is a statement or opinion of an individual which also is not present in the courtroom, not subject to cross-examination and we have no way of determining the validity or accuracy of research used in developing this opinion.

[147] THE COURT: I overrule the objection for the reason, as a businessman, he would take certain action, based on the advice given to him by his legal staff and the other individuals.

And this question, I assume, is directed to his business reactions to the advice and not to whether or not—not to the question of whether or not that advice was—

MR. BOOHER: If I understand the Court's ruling then, the relevancy of the answer to this question will be limited to the business purpose for this witness doing whatever he did.

It will not involve a correct or incorrect interpretation of Title 12 U.S.C.A. 92, no legal interpretation, correct?

MR. WATSON: No; just his understanding of what these provisions meant.

THE COURT: That's right.

THE WITNESS: Your Honor, I can enlarge on that a little bit from actual experience.

We acquired a state bank.

MR. BOOHER: I don't believe this answer is responsive to the question.

THE WITNESS: Well, I was going to report—what I was going to report was the examiner's—

THE COURT: Do you want it read back again?

THE WITNESS: I believe so.

[148] (Record read.)



THE WITNESS: My answer would be yes on that.

By MR. WATSON:

Q. Would a bank seek to have borrowers to take credit life insurance whether or not they received income of any sort from the insurance written?

MR. BOOHER: I object to the question as being too general and speculative.

THE COURT: Rephrase it and say, "Did a bank"? et cetera. You are saying, "would a bank", I believe.

Read the question back again, Mr. Reporter.  
(Record read.)

THE COURT: If you change that would to did, do you remember the question now?

THE WITNESS: Yes.

MR. WATSON: Let me put it this way.

MR. BOOHER: I understand the witness has some papers there.

Are those notes?

THE WITNESS: I have papers, but I answer without them. I was trying to hurry things up.

THE COURT: You can refresh your recollection if you need figures.

I think he was doing that for the record to show that perhaps some of this was not coming off the top of his head.

[149] By MR. WATSON:

Q. Is there a benefit to the Petitioner banks to having credit life insurance, whether they receive any income as a result of the insurance being written on the lives of those borrowers?

MR. BOOHER: I object to the question.

Do you say is there a benefit with no income? The question is rather confusing to me. What is the purpose of this question?

MR. WATSON: I have in mind the Security.

THE COURT: The objection is overruled.

You may answer the question.

THE WITNESS: There is benefit.

It assists you in the credit goodness of your loan. If you are making a loan and a man has no other assets than his earning power or his salary and he should die before the

loan is repaid, a personal loan, and you got credit life protection on it, you take no loss and your loan is paid off.

By MR. WATSON:

Q. Thank you.

In the years 1959—or 1954 through 1959, were there any contrast between the First Security Company or the employees of that company and American National with respect to selling or handling life insurance or credit life insurance?

MR. BOOHER: If I may, could I ask the reporter to [150] reread that question?

THE COURT: Read it back, please, Mr. Reporter.

(Record read.)

THE WITNESS: Not to my knowledge. I think not.

MR. BOOHER: If I may—

THE COURT: Written contracts, do you mean?

MR. WATSON: Yes.

THE COURT: Yes.

MR. BOOHER: May I have a few minutes discussion?

THE COURT: Yes.

Off the record.

(Discussion off the record.)

THE COURT: Back on the record.

By MR. WATSON:

Q. Does the First Security Company hold any agent's license to sell life insurance?

A. No.

Q. Does the First Security Company license any personnel in that organization to sell life insurance?

A. No, they couldn't.

Q. Does the company have—does the First Security Company have any contact with the public with respect to selling life insurance?

A. No.

MR. WATSON: You may cross-examine.

[151] CROSS-EXAMINATION

By MR. BOOHER:

Q. Mr. Eccles, I understand that the First Security Life Insurance Company is now owned by the First Security Investment Company?

A. That's right.

THE COURT: Let me hear that question again, Mr. Reporter. Please, read it back.

(Record read.)

THE COURT: All right.

By MR. BOOHER:

Q. Is there any prohibition at the present time under the provisions of the bank holding company Act which would prevent First Security Life Insurance Company of Texas from becoming a full-line security company?

MR. ALLEN: That calls for a conclusion, your Honor. We object.

THE COURT: Well, I am going to let him answer that question.

THE WITNESS: First Security Investment Company is not a bank holding company. It doesn't come under the bank holding company Act at all.

They own it.

MR. BOOHER: The answer is not responsive to my question.

[152] I request the reporter to reread the question.

THE WITNESS: Yes, May I have the question again?

THE COURT: Reread it, Mr. Reporter.

(Record read.)

THE WITNESS: No.

THE COURT: For the reasons—

THE WITNESS: There are provisions in the bank holding company Act, your Honor, that would prevent it, but you couldn't organize one in the bank holding company. You couldn't do that.

By MR. BOOHER:

Q. The same would also be true from the year 1959 through the present time since the First Security Life Insurance Company of Texas has been owned by the First Security Investment Company since 1959?

A. In my opinion, yes.

Q. So, since 1959 through the present time, there has been no feature of the bank holding company Act which would have prevented the First Security Life Insurance Company from becoming a full line life insurance company?

A. No, because there is no relationship.

Q. Now, First Security Company—did First Security Company request a ruling with respect to whether the bank holding company could retain ownership of the First Security Life Insurance Company of Texas pursuant to the provisions of the bank company holding Act?

[153] A. Did they?

Q. Yes?

A. No, they didn't.

Q. They have not requested any such ruling?

MR. WATSON: He refers to the company and there might be some confusion.

THE COURT: Just a moment.

Come on, gentlemen. Let one party speak at a time.

If you don't, my record is going to be so confused that you won't understand it, and I won't understand it, so if there is an objection, allow counsel to finish it and by the same token, allow opposing counsel to get his words in singly or separately now.

Where do we stand? Who is doing what?

MR. WATSON: I am sorry, your Honor.

All I was trying to do was clear up the confusion between the company and the corporation and I probably was out of order.

THE COURT: No, you were not. You were within your—you are perfectly in order and there may have been confusion there, because I can see how this is confusing as I have been following it.

And everytime you say company or corporation, I have my notes here and I take note of the differentiation and it is difficult because they both have the same names.

[154] Are you sure you had your designations correct?

MR. BOOHER: I asked the reporter to reread the last question.

THE COURT: All right, reread it, Mr. Reporter.

(Record read.)

THE WITNESS: The answer is no.

THE COURT: Proceed.

By MR. BOOHER:

Q. I understand the question was answered no, is that correct?

A. That's right.



THE COURT: Off the record.

(Discussion off the record.)

THE COURT: Back on the record.

By MR. BOOHER:

Q. I believe you testified that the banks would receive a benefit from the sales of credit insurance even if it received no income from this type of activity.

In fact, however, the banks did receive a commission from the sales of credit insurance or the management company received such a commission on sales of credit insurance through the banks prior to 1954?

MR. ANDERSON: I object to that question.

This record shows that the banks never took in one penny of commission or any other form of return from the sale [155] of credit life insurance at any time in the history of this banking organization.

THE COURT: Yes, but Mr. Eccles is very competent and a very capable witness.

MR. ANDERSON: But Mr. Booher assumed in his question that the banks had taken in the commission so the question is improper.

THE COURT: Let me have Mr. Eccles' answer, I think he knows more about this banking business than anybody else in the courtroom and even more than I.

THE WITNESS: The answer is we never took commissions.

THE COURT: Proceed.

I think you have to recognize, gentlemen, I am not controlled by the question at all. I don't pay any attention to it.

I look to the answer and any inference in the question is not going to be taken into consideration in any opinion that I write in this case.

By MR. BOOHER:

Q. I understand that our stipulation is to the effect that before 1954 the First Security Management Company reported a commission on the sales of credit insurance to customers of Petitioner banks.

I didn't understand that last—

MR. ALLEN: There isn't a question there, your [156] Honor.



THE COURT: He hasn't asked a question yet.

By MR. BOOHER:

Q. But that is a stipulation that commissions were paid on sales of credit insurance through Petitioner banks prior to 1954 and that commission was reported in taxable income by the First Security Management Company?

MR. ALLEN: Let's have him read the stipulation if we are going to preface the question—

MR. ANDERSON: The stipulation states that. We stipulate to it. The stipulation says that First Security Management Company during the years '48 to '52 reported commissions that were paid under an insurance agency agreement with Ed D. Smith and Company, executed by Credit Life of Springfield and American Life of Florida.

The management company did take the commission and that is what the stipulation states and we will rest on that.

THE COURT: Let me say something, gentlemen.

It is going to be too confusing if I find three lawyers on Petitioners' side of the room, one making objections and one asking questions on direct examination and someone else making statements.

I think you had better get together and nudge one another, but let me have one lawyer from the Petitioners' side make the objections.

[157] You can nudge Mr. Watson and I will give you plenty of time to discuss any objection. I would prefer to have one man making the objections as it is too confusing otherwise.

Go ahead, Mr. Booher. You understand now what the agreement is regarding the stipulation and I think the witness knows, too.

Do you have a question?

By MR. BOOHER:

Q. With respect to sales of credit insurance before 1954 to customers of Petitioner banks, Petitioner Management Company did in fact receive a commission on such sales; is that your understanding?

A. I don't think it was a commission. I think it was a reimbursement of expenses, a certain reimbursement.

They were not an insurance agency and they couldn't receive a commission.

They had no agency. They could be reimbursed and that is all, for expenses.

MR. BOOHER: If I may, your Honor, I would refer back to the stipulation which is that the management company—

THE COURT: The stipulation under our rules is controlling, as you know.

So, I don't think you need say anything further. You know what the rules provide.

By MR. BOOHER:

[158] Q. Is it your understanding, Mr. Eccles, that the management company and the banks have never received a commission on the sales of credit insurance before as well as after 1954?

A. A commission, no.

Q. Now, we have stipulated into evidence the income tax returns of Petitioner Management Company for the years 1955 through 1959 as Exhibit C-3.

I can furnish you these returns to look at it if you desire, but my question is, did Petitioner, management company report income from commissions on the sales of insurance during the years 1954 through 1959?

A. I have never seen the returns. I didn't make them.

Q. I would take it your answer is you have no personal knowledge as to whether they did or not?

A. I have no knowledge of it.

Q. Would your answer be that you have no personal knowledge as to whether they reported a commission from the sale of insurance before 1954 also?

A. I haven't been over the income tax returns.

Q. Well, do you presently have any knowledge as to whether they did report a commission prior to 1954?

A. I have no present knowledge of it, no.

THE COURT: You have no present knowledge?

THE WITNESS: No. Expenses, I think, but not [159] commission.

THE COURT: All right.

You mean reimbursement of expenses?

THE WITNESS: That's right, your Honor, yes.

THE COURT: Mr. Booher, if your examination is drawing to a close, I will take a five-minute recess if it will facilitate things.

Are you getting near the conclusion of it or—

MR. BOOHER: I would appreciate a five-minute recess and I can finish this up within a few minutes after the recess.

THE COURT: Very well.

We will recess for five minutes, then.

(Short recess.)

THE COURT: Back on the record.

Proceed, Mr. Booher.

By MR. BOOHER:

Q. As I understand your testimony, the First Security Life Insurance Company of Texas is not today a multiple line or full line life insurance company; is that correct?

A. That's correct.

Q. Now, in discussing the expansion of the subsidiary corporations owned by the two holding companies, I don't believe you discussed a foreign corporation known as F.R.G. Company, a Lichtenstein Corporation, right?

[160] MR. WATSON: We are going to object to this, your Honor, because anything on the Lichtenstein Corporation has been excluded from the record as being prejudicial.

THE COURT: Did I admit that?

MR. WATSON: You excluded all of that yesterday.

THE COURT: The objection is sustained.

MR. BOOHER: The evidence was offered at that time on the issue of tax avoidance or tax motivation and since that time the witness has testified to the reasons why the First Security Life Insurance Company of Texas did not develop into a multiple line life insurance company.

We believe that the testimony concerning the first F.R.G. Corporation will be relevant as explaining as why this corporation has so developed, that is, the Texas life insurance company, since much of the income from the sales of credit insurance was diverted from the First Security Life Insurance Company of Texas into the foreign corporation.

This evidence is also relevant with respect to Petitioners' business purpose for using the First Security Life Insurance Company of Texas since they state that they formed this company as an investment company to generate income from investments.

The activity of Petitioners in diverting income from the First Security Life Insurance Company of Texas into the First R.G. Corporation would be inconsistent with the opinion.

[161] On these points we believe that testimony concerning the F.R.G. Corporation is relevant to the issues in this case.

MR. WATSON: I don't see where it could at all be relevant to the business reasons for organizing a First Security Life Insurance Company back in 1954 to what happens in 1959 or 1960 pertaining to the foreign corporation.

And it certainly doesn't have anything to do with whether the First Security Life Insurance Company could become a full direct writing life insurance company.

It is another thing done many years later and for different purposes.

THE COURT: I am going to permit the witness to answer. You may answer.

MR. BOOHER: I request the reporter to read the last question back.

(Record read.)

MR. WATSON: May I make one further objection?

MR. BOOHER: There is no objection to the question as actually being asked. There is no basis for an objection at this point.

THE COURT: Yes.

By MR. BOOHER:

Q. When was the First R.G. Corporation formed?

MR. WATSON: I am going to object to that. This [162] corporation has nothing to do with the issues involved in this case. It isn't related to any of these Petitioners that are before the Court.

And it is—it functions years that were subsequent to the years that are in issue.

THE COURT: The objection is overruled.

You may answer the question.

MR. BOOHER: If I may—

THE WITNESS: I am not sure of the date.

By MR. BOOHER:

Q. If I said that it was formed in the latter part of 1959, would that be substantially correct?

A. Yes. I can answer yes to that.

Q. Was the business of the First R.G. Corporation primarily the reinsurance of credit insurance sold to borrowers of Petitioner banks?

A. Together with automobile casualty insurance.



Q. It dealt with other types of insurance also?

A. Automobile casualty, yes.

Q. What advantages did the First R. G. Corporation have over the First Security Life Insurance Company of Texas?

A. It could write auto casualty. It was a foreign corporation and it could invest in foreign securities.

Q. However, the premiums paid into the First R. G. Corporation with respect to credit life, health and accident [163] insurance could equally as well have been paid into First Security Life Insurance Company of Texas?

MR. WATSON: I object to that as being argumentative and outside the issues in this case.

THE COURT: Overruled.

You may answer.

THE WITNESS: They could have been, but they couldn't have been used for foreign investments which was our purpose at that time because of the foreign money market and the domestic money market.

We were able to invest in Barkeley Bank of London at six and six and a half per cent while the rate in this country was three per cent.

Every dollar in reinsurance in the reinsurance company was invested in foreign investment and because of my knowledge in the foreign field, working in the World Bank and in the Marshall Plan.

MR. BOOHER: Could you please reread the question, Mr. Reporter?

THE COURT: Yes—no. You may finish, Mr. Witness.

THE WITNESS: We felt that the foreign market was very desirable in relationship to the rate of interest that we could get on securities domestically.

For several years the foreign money such as the English pound, the German mark, the Italian lira, the Belgium franc and others were sound.

[164] There wasn't a question of the valuation at that time. We even put our money in without hedging the foreign exchange at all. We did it to increase the incomes you could get by making foreign investments.

By MR. BOOHER:

Q. And was the First R.G. Corporation liquidated?

A. It was.



Q. When was it liquidated?

Was it approximately in 1963?

A. It was liquidated when the pound sterling became very weak.

It was talked of devaluation. All your foreign currency became very weak in relation to the dollar and just the investment field wasn't conducive in the foreign after that time—or about that time.

Q. And at the time of its liquidation, the F.R.G. Corporation paid a liquidating dividend to its parent corporation—

MR. WATSON: We object to this, your Honor. It is going way outside the issues in this case.

It has nothing to do with what we are dealing in.

THE COURT: Yes. We have gone far enough into this, Mr. Booher.

By MR. BOOHER:

Q. Now, according to your testimony, or your understanding [165] of the Title 12 U.S.C.A. Section 92, receipt of a commission was illegal.

If so, why as a businessman could you not provide a cheaper insurance for your customers or have the banks rebate their over charges to your customers?

A. We charge the rate which is permitted by state law. We charge the rate that was charged by our competitive finance companies and our customer finance companies. There was no reason to go ahead and give a lower rate.

Q. Well—

THE COURT: Let him finish his answer.

THE WITNESS: That is all I have.

By MR. BOOHER:

Q. In charging the prevailing rate at least for the years before 1954, did not that prevailing rate usually include the payment of a commission or a retrospective rebate to the lending entity or an affiliated entity?

MR. WATSON: I want to object to this question.

He is asking the witness about questions that require an intimate knowledge of the insurance business and how they operate, how they figure their commissions, what sort

of actuarial data they base their figures on, I don't think it is proper.

THE COURT: Well, Mr. Eccles will be able to handle the question.

[166] You may answer, sir.

THE WITNESS: May I have it repeated?

THE COURT: Yes.

Please read it back, Mr. Reporter.

MR. WATSON: Another thing, or another point that I think that we ought to object to is that it doesn't say payment to who? There is nobody designated as the recipients.

MR. BOOHER: I withdraw the question.

THE COURT: All right.

I was having trouble understanding the ramifications of it, too.

By MR. BOOHER:

Q. I understand your testimony is that Petitioner banks charged the prevailing rate with respect to credit insurance sold to bank customers sold before 1954?

A. I think they did. To my knowledge they did.

Q. Did not the prevailing rate charged on credit insurance before 1954 make allowance for the payment of a commission or a retrospective rebate to the lender or a related entity?

MR. WATSON: I hate to keep interrupting, but I think once again this is a question for an insurance man.

THE COURT: Well, I have ruled on that.

You may answer, sir.

THE WITNESS: The prevailing rate was set by the [167] State Insurance Commissioner.

I don't know how he set the rate.

By MR. BOOHER:

Q. Did the First Security Management Company report in its taxable income commissions on the sale of credit insurance for the years before 1954?

THE COURT: I think that has been answered—or that has been asked before.

MR. BOOHER: It has been answered and it has been stipulated also.

By MR. BOOHER:

Q. The answer is yes?

A. My answer wasn't yes.

THE COURT: The record will show what the answer was. That question was asked and there was an answer previous to our recess.

Now, whatever the record shows the answer was, that is what the answer is.

By MR. BOOHER:

Q. Did the First Security Banks charge the prevailing rate on sales of credit insurance to their customers before 1954?

MR. WATSON: Your Honor, the banks don't charge the rate.

[168] That is the insurance company.

THE COURT: I am aware of that. I mean the way the question is framed is not going to confuse me.

Has your answer right along been whatever they were told to charge, they charged?

THE WITNESS: The bank acted as agent for the borrower and they collected the rate that was specified in the rate schedule and they acted as an agent to remit that to the insurance company to cover the cost of the insurance.

THE COURT: I am aware of the factual background, yes.

MR. BOOHER: I have no further questions.

THE COURT: Any redirect?

MR. WATSON: No redirect, your Honor.

THE COURT: Thank you, sir, you are excused.

(Witness excused.)

THE COURT: Call your next witness, please, sir.

MR. ANDERSON: I call Tom Hawkes.

THOMAS F. HAWKES

was called as a witness on behalf of the Petitioners, and, having been first duly sworn, testified as follows:

THE CLERK: Take the witness stand, sir, and for the record, may we have your name?

THE WITNESS: Thomas F. Hawkes, H-a-w-k-e-s.

THE CLERK: And your address, sir?

[169] THE WITNESS: 1149 Bonneville, B-o-n-n-e-v-i-l-l-e, Drive, Salt Lake City, Utah.

DIRECT EXAMINATION

By Mr. ANDERSON:

Q. What is your business, Mr. Hawkes?

A. Vice-president and treasurer of the First Security Corporation.

Q. How long, please?

A. I had the title of vice-president since 1950, prior to that time having the title of comptroller.

Q. To clear up what has gone on previously by—

MR. ANDERSON: Strike that.

By Mr. ANDERSON:

Q. To clear up what has gone on previously about commissions from 1948 to 1952, the stipulation has been read into evidence and it was that from '48 to '52 there were agency agreements with Ed D. Smith & Sons outstanding with Credit Life of Springfield and American Bankers Life of Florida whereby there would be a commission paid to Ed D. Smith & Sons for the sale of Credit Life Insurance by the banks.

Now, during this period of time, was this income under the—that is the income to go to Ed D. Smith & Sons taken into income by the First Security Company?

A. Yes.

Q. And reported on their tax returns?

[170] A. Yes.

Q. Was there any special reason for that?

A. Well, the banks at that time were just getting into the installment credit field in a big way.

Prior to that it was very small. As we entered into that field we got into this credit life program.

To start out with, it was very small. And this arrangement was entered into by our subsidiary Ed D. Smith & Sons.

Checks were issued by these insurance companies to Ed D. Smith & Sons for these commissions. For some reason, I can't tell you why, for no better place to put it, it went through the books of First Security Company.

Q. Was that a constitution made by management?



A. No. It seemed to happen because of the smallness of the amounts. It was deemed of no consequence at the time.

As it became larger, then at that time it did come before management.

Q. Was that about the time that Security of—Security Life of Texas was formed?

A. Yes.

Q. And the problem was then eliminated?

A. Yes.

MR. BOOHER: I object to the line of questions as being leading.

[171] MR. ANDERSON: This line is through.

THE COURT: The answer will stand.

By MR. ANDERSON:

Q. From 1954 through 1959 Mr. Booher asked on his examination of Mr. Eccles whether an item—

MR. BOOHER: I object to that as a leading question in the examination of a different witness.

THE COURT: Overruled.

This is preliminary to another question.

By MR. ANDERSON:

Q. —stated that an item appeared on the tax returns of the First Security Company referring to insurance commissions.

I show you Exhibit C-3, the tax returns of the First Security Company and an item on one of those returns.

Would you please read the item?

A. The top one?

Q. This item.

A. "Commissions insurance gross."

Q. Were those commissions—what were those commissions—what does that refer to?

A. Well—

Q. Does this refer to—

A. It is an item of income reported. Definitely, it is not a commission. It applies only to automobile casualty insurance.

[172] Q. Does it have anything to do with the insurance involved in this suit, credit life insurance?

A. No.

Q. Is the word "commission" in there appropriate?



A. No, definitely not. It is not a commission.

Q. Explain to the judge, so that this record will be clear, just how management company from 1954 through 1959 was handling automobile casualty insurance, and why this item of income would appear on these tax returns.

A. Well, during this period, banks were getting into the automobile finance deal. It was new. It was very difficult to obtain insurance on the automobiles financed. In fact, we couldn't get it. So we had to go—on I believe they call it a retrospective plan in which we absorbed the loss.

If for some reason or other it did show in the black, there was a refund made, and that is what this particular item was, pertaining only to automobile casualty insurance.

Q. Was that a profit function for the company?

A. No. Over the years it has been a loss.

Q. Was it meant to be a profit function for the company?

A. No.

Q. What was it meant to be?

A. It is just a method of obtaining insurance. We couldn't have claimed it in any other way.

[173] Q. Would it refresh your recollection if I stated that it was to cover expenses that the company incurred?

MR. BOOHER: I object to that as a leading question.

THE COURT: I sustain the objection. It is leading.

By MR. ANDERSON:

Q. Did the company incur any expense in writing any automobile casualty insurance during these years from 1954 through 1959, the management company?

A. There were some expenses incurred in the writing of that insurance, yes.

Q. Did the retrospective rebate have any relationship or bearing—any relationship to these expenses?

A. No. It could have gone either way. This particular year it evidently produced a return. However, there were other years where it was in the red more or less.

Q. Has the company made an overall profit from handling automobile casualty insurance?

A. I would say no.

Q. Was the word commission on those taxable returns a conscious decision by management? Do you know how it got there?

A. Well, "commission" is not the right word. I think it

is probably just following the tax form, isn't it? It definitely isn't a commission. It is an experience factor [174] there that was paid back to the company.

MR. ANDERSON: You may cross-examine.

CROSS-EXAMINATION

By MR. BOOHER:

Q. If I understand your testimony, this automobile insurance is insurance taken out on automobiles financed by the bank?

A. Yes.

Q. And the premium was paid by the purchaser of the automobile?

A. Right.

Q. And at the end of the period there would be a determination as to whether that premium was excessive or perhaps insufficient?

A. I suppose that is it. What is the right term, retrospective? Is that the word?

Q. Well, in the event that it were determined or found that the premium paid by the customer was excessive, would that excess be refunded to the customer?

A. No.

Q. That excess would be returned—or retained by the First Security Company?

A. Right.

MR. BOOHER: I have no further questions, Your Honor.

THE COURT: Any redirect?

[175] MR. ANDERSON: May we have a moment?

THE COURT: Yes.

MR. ANDERSON: That is all we have.

Thank you, Mr. Hawkes.

THE COURT: You may step down, Mr. Hawkes. You are excused.

(Witness excused.)

MR. WATSON: Could we have a minute or two?

THE COURT: Let the record show that yesterday when you were introducing a number of exhibits the Court excluded some and admitted others, and this is going to affect your stipulation of facts, your supplemental stipulation of facts, and I am not sure whether it is on the record or not,

and I want it on the record that what you are going to do is submit another exhibit to the Court which will reflect the number of exhibits which were admitted and the number of exhibits which were excluded.

Is that right?

MR. BOOHER: That is correct, Your Honor.

THE COURT: Is that your understanding, too, counsel for Petitioners?

MR. ANDERSON: The exhibit that we are going to talk about now has been previously marked—

THE COURT: I don't want to get into anything we are talking about now.

[176] Yesterday at the start of the trial, the Court ruled out several exhibits and it admitted several others, the ones that you objected to for materiality and relevancy having been excluded, and all of this.

Now, since you have a stipulation of facts before the Court listing those exhibits which you thought would be admitted into evidence, which were not admitted, to that stipulation of facts I want another exhibit attached or some statement attached regarding the exhibits which are in evidence, and those which were excluded.

MR. ANDERSON: Very well. We will prepare such a list and submit it.

THE COURT: The minutes of the Court will have to show this, and I realize that we are getting outside of our normal routine by virtue of the manner which we proceeded, and this will take care of that.

MR. ANDERSON: We will prepare such a list, and submit it to the Clerk, Your Honor.

THE COURT: All right. Proceed.

MR. WATSON: Your Honor, as you will recall in some of the pretrial conferences, we made an arrangement to put on a time and cost study prepared by Mr. Hermansen. We would like to call Mr. Hermansen for that purpose.

THE COURT: All right.

MR. WATSON: Also, in accordance with the agreement [177] reached at the pretrial conference, we said we would make a very brief explanation in order to save time. This was a study made at our request by Mr. Hermansen to determine the actual cost to the Petitioner banks and to the Petitioner companies for processing, handling the insurance certificates, collecting the money, transmitting them from

the banks to the Petitioner companies, and from the company down to American National.

Now, with that preliminary explanation, we are offering Exhibit—Petitioner's Exhibit 57 for identification and having Mr. Hermansen take the stand for the purpose of cross-examination by the Respondent.

THE COURT: Very well. He may be sworn.

PHIL J. HERMANSEN

was called as a witness on behalf of the Petitioners and, having been first duly sworn, testified as follows:

THE CLERK: Take the witness stand, sir, and may we have your name, please?

THE WITNESS: Phil J. Hermansen.

THE CLERK: What is your address?

THE WITNESS: 1622-25th Street, Ogden, Utah.

#### CROSS-EXAMINATION

By MR. BOOHER:

Q. Am I correct in your understanding that the general procedure for handling credit insurance during the years 1954 [178] through 1959, which are reflected in your study, are substantially as follows, that when a loan officer in the installment loan or commercial loan department of the First Security Banks interviewed an application for loan, they briefly explain to the borrower that insurance was available to assist them to pay off the loan that they had if the borrower died?

A. Yes.

Q. Then the loan officer would give the borrower an application form; is that correct?

A. That is my understanding, yes.

Q. And the application form would be filled in by personnel of Petitioner banks?

A. No. The application form would be filled in by the borrower.

Q. Then what forms were filled in by personnel of Petitioner banks?

A. The certificate or the application for certificate.

Q. And on completion of the certificate or application for certificate, as you call it, the document will be executed by the borrower?



A. In some cases it didn't require an execution. It was a group policy.

Q. At the time these forms were completed, was the full amount of the premium collected from the borrower?

[179] A. Yes, or added to the loan.

Q. And thereafter the amount of the premium, together with the completed forms, was transmitted to the Petitioner, First Security Management Company?

A. Correct.

Q. And then First Security Management Company transmitted the completed forms and the premium to the American National Insurance Company?

A. That is right.

Q. Now, this study that you have made, was this study made recently in connection with this case?

A. Yes.

Q. This study was not made contemporaneously with the years involved?

A. No.

Q. This study was not made for management purposes during these years?

A. No.

Q. This study was made for purposes of this litigation?

A. Yes.

MR. BOOHER: I have no further questions.

THE COURT: Any redirect?

MR. WATSON: There is just one thing we want to look at in the exhibit, Your Honor, and we will offer it into evidence.

[180] THE COURT: Is there another copy?

MR. WATSON: We have no redirect, Your Honor, and we are at this time offering the exhibit into evidence.

MR. BOOHER: No objection, Your Honor.

THE COURT: All right. Now, gentlemen, it is agreed that this witness is qualified, and all that, to proceed with this? There is no objection to that part of it?

MR. BOOHER: My understanding is that this is not a type of study which requires special qualifications. It is a mathematical computation.

MR. ANDERSON: May I speak?

THE COURT: Yes.

MR. ANDERSON: The study does require intimate business knowledge of Mr. Hermansen with the operations of the

company, not just any Tom, Dick or Harry, to go around and interview the people.

He spent many weeks traveling around to branches and talking to the people involved. He is especially qualified.

THE COURT: I meant a cover sheet showing his qualifications on what he had done.

MR. ANDERSON: If that would help the Court, we will ask him those questions, unless Mr. Booher will stipulate to his answering and qualifications as an officer in the business.

[181] THE COURT: Mr. Booher?

MR. BOOHER: I think—

THE COURT: Well, I think we had better put on the record his qualifications.

#### REDIRECT EXAMINATION

By MR. WATSON:

Q. Mr. Hermansen, what offices do you hold with the First Security Company?

A. I am assistant secretary and assistant treasurer.

Q. How long have you held those offices?

A. Over 25 years.

Q. And have you been with the First Security Company for 25 years?

A. Thirty-one years, sir.

Q. As the assistant secretary and assistant treasurer, what is the nature of your duties?

A. Presently preparation in the supervision of the—supervision in the preparation of our tax returns, supervision in personnel operations in our immediate office, and the management company, I should say.

In the past I have also been in charge of our complete personnel operations, so I am thoroughly familiar with the various job classifications and positions and what these people do in each of our offices.

Q. And in connection with your employment you have had [182] ample opportunity to become familiar with the manner in which these insurances are processed; is that correct?

A. That is correct.

Q. Would you explain to the Court the procedure you followed in making the study that we presented as Exhibit 57?

A. Yes. Through interviews with the various people in—

volved, I determined the procedures at the office level for both the management function and the clerical function.

I also determined the procedures at the management company level.

I sent these procedures out in written form, which is included in the exhibit, and through interviews with the people actually doing these jobs, some of these in person, some by telephone, verified by letter from them later, I determined the average length of time for each of the procedures.

We then determined from records available the number of policies written, the number of refunds made, the number of claims paid, so we had a complete total for each procedure.

And multiplying these out, we arrived at a total number of hours for the operation.

I then went back to our personnel records and from actual records I determined the number of weeks paid to each of the people involved in these procedures.

[183] The actual weekly salary by week, and multiplying this out, multiplying each rate by the number of weeks that rate was paid, and dividing by the total number of weeks, I arrived at the average weekly salary.

I then determined—it is commonly known as fringe benefits, although it is probably a misnomer—the benefits applicable to the salaries, by taking the total benefits—may I refer to my notes here?

THE COURT: Yes.

THE WITNESS: These benefit costs included Social Security, Federal and State Unemployment, Workmen's compensation, group insurance, retirement contributions, bonus and vacation costs.

When I obtained the dollar figure for these for each company involved, by dividing this dollar figure by the total salaries paid, I determined the fringe benefit cost per salary dollar, and by multiplying the average weekly salary by this factor I determined the fringe benefit for each salary, thus arriving at an average cost per week.

Our average work week is 40 hours. Dividing this average cost by the 40 hours, I arrived at an hourly rate.

I developed this procedure both for the executive level and the clerical level.

And then multiplying the total number of hours by

the average salary obtained, I obtained a cost figure, the [184] total cost figure.

I then determined the weight of the policies of the cancellations claimed, to determine a postage cost. An allowance was included in this to cover cost of transmittal documents, tapes, and other things.

Adding this cost to the salary and benefit cost, I arrived at a total cost, following the procedures set out.

MR. ANDERSON: We have nothing further, Your Honor, if that satisfies the Court.

THE COURT: And have you made, not similar studies, but have you done work of this nature before for the company?

THE WITNESS: I have made some special studies, yes, in various departments.

THE COURT: That is what I meant.

THE WITNESS: To determine the cost of the department.

THE COURT: And did you have clerical help and other perhaps professional help, if you care to call it that, in preparation for this report?

THE WITNESS: I consulted with members of our CPA firm as to whether my procedures would adequately give a true cost, and they—

THE COURT: They approved of your procedure for this computation?

THE WITNESS: Yes.

[185] THE COURT: All right.

I assume that concluded your direct, did it? Or your redirect?

MR. ANDERSON: It did.

THE COURT: And there is no recross?

MR. BOOHER: No.

THE COURT: Thank you very much, sir, you may step down.

And Exhibit 57 is received.

(Witness excused.)

(The document previously marked for identification Petitioners' Exhibit No. 57, was received in evidence.)

MR. ANDERSON: Your Honor, may we take a moment to set this screen up?



THE COURT: Yes. We are going to recess at five minutes to 12:00. I am due at a luncheon at 12:15.

MR. ANDERSON: I suggest that I take this time now before the lunch hour to put up the screen and spend the next ten minutes qualifying the next witness so that after lunch we can get started.

Is that satisfactory?

THE COURT: All right.

MR. ANDERSON: I call Mr. Arthur Crooks Eddy.

[186]

ARTHUR CROOKS EDDY

was called as a witness on behalf of the Petitioners and, having been first duly sworn, testified as follows:

THE CLERK: For the record, may we have your name?

THE WITNESS: Arthur Crooks Eddy.

THE CLERK: How do you spell your middle name?

THE WITNESS: Just like it sounds, C-r-o-o-k-s.

THE CLERK: How do you spell your last name?

THE WITNESS: E-d-d-y.

THE CLERK: And your address, please?

THE WITNESS: 2456 Hanover West Terrace, Atlanta, Georgia.

#### DIRECT EXAMINATION

By MR. ANDERSON:

Q. What is your business, Mr. Eddy?

A. Consulting actuary.

Q. With what firm?

A. With the firm of Bowles, Andrews & Towne.

Q. How large is that firm?

A. The number of employees do you mean?

Q. How large geographically, and the number of employees.

A. Geographically, we have offices spread up and down the East Coast, one at Atlanta, one at Richmond, and one in New York, and one in Portland, Maine.

We have approximately 100 employees in the firm.

[187] Q. Are you in the Atlanta office?

A. Yes.

Q. How many employees are there in the Atlanta office?

A. Approximately 60.

Q. What is your position in the Atlanta office, and with the company?

A. I am managing partner in Atlanta, and with the firm

I am deputy managing partner.

Q. When did you begin your actuarial career?

A. 1948.

Q. Where?

A. Pilot Life Insurance Company, a subsidiary with the Jefferson Standard in Greensboro, North Carolina.

Q. How large is that company?

A. As of the current date, the combined company is about tenth in size, based on assets, tenth amongst the stock companies in the United States.

Q. When did you leave the company and what position did you hold?

A. I left the company, Pilot Life Insurance Company, in August of 1962, and at that time I held the position of second vice-president—

Q. Are you a fellow of the Society of Actuaries?

A. Yes.

Q. What year did you become admitted as a fellow?

[188] A. In 1955.

Q. What did your duties at Pilot Life Insurance Company include, please?

A. The general scope of actuarial work that is required by the home office personnel of a life insurance company.

Q. When did you join Bowles, Andrews & Towne, your present firm?

A. As of August 1962.

Q. In what position?

A. I joined the firm as partner in charge of the Atlanta office.

Q. Then became, as you said, deputy managing partner of the firm?

A. Yes.

Q. Have you held any positions with the Life Office Management Association?

A. Yes, sir, I have. I have been on the Educational Council.

Q. Are you a member of the Academy of Actuaries?

A. Yes.

Q. Are you fully accredited as an actuary?

A. Yes.

Q. Are you familiar with the credit life insurance business, Mr. Eddy?

A. Yes.

[189] Q. Explain to the Judge how you are familiar with that industry.

A. It began with my experience at Pilot.

In the mid-Fifties, Pilot was very active in the credit insurance business, and this became a very substantial part of their group operation during that period of time, and it was necessary in the duties of the actuarial department to assist in matters relating to the credit insurance business of the company, and this was the total scope of operations, and it included various facets of credit life.

Q. What has been your contact with the credit life business since that time?

A. Our firm are consultants for a number of credit life insurance companies, or companies writing credit life insurance.

Q. Can you express to the Court the percentage of credit life in force through your firm in relation to what is in force in the United States?

A. Amongst our clients, the total is ten percent, or in excess of \$6 billion a year.

Q. Is that considered large, small or medium?

A. A volume of \$6 billion out of approximately \$60 billion.

Q. Do you consider yourself familiar with the industry?

A. Yes.

[190] Q. During the years 1954 through 1959, what was the standard premium rate for decreasing term credit life insurance?

A. Single premium decreasing term, one dollar per hundred.

Q. Level term would be what?

A. Two dollars per hundred.

Q. In evidence in this case are group credit life policies by American National, issued on lives of debtors of First Security Banks of Utah and Idaho. Those policies state a figure of one dollar and 54 cents.

Would you explain to the Court whether that constitutes any variation in rates from the one dollar a hundred in rate you just quoted?

A. Only in that this \$1.54 was derived from an average of the premium rates demonstrated in the table within the contract.

Those premium rates varied by age and issue, and in the aggregate were assumed to be \$1.54 on an average, and this



is per thousand, and this translates to precisely one dollar single premium per \$100.

Q. The banks were charging the going rate during the years in suit?

A. Yes.

Q. The Government had admitted into evidence Exhibit [191] C-J which you have previously examined, which contains formulas for various rates.

Are these formulas in any way inconsistent with what you have just testified to?

A. Not in my opinion.

Q. Are you familiar with the First Security Life Insurance Company, of Texas?

A. Yes, sir.

Q. At our request have you examined its operations?

A. Tell the Court why a company would begin by reinsuring only.

A. Well, the major purpose for commencing a life insurance company operation through reinsurance would be a reduction in initial capital requirements.

For instance, to start a life insurance company it is necessary to have a considerable amount of capital, too, for tool-up expense, for organizational expenses, for developing such things as premium rates, policy forms, mechanical forms for data processing.

These could be obtained generally as a reinsurer by employing someone else's forms.

Q. Is there any comparison between a life insurance company, such as Security Life of Texas, and the life insurance agents?

[192] A. No, sir. Businesswise they are different concepts.

Q. Explain to the Court just how different those concepts are.

A. As an agency organization, an entity would be concerned with simply selling an intangible product, and its sole interest in this product would be in the commissions or the compensation received for its efforts in the sale.

A life insurance company, on the other hand, is in the business of assuming risks, and is in the business of dealing with probabilities, a substantially different principle.

Q. Describe the differences, if any, between a reinsurance company and a direct line insurance company, the fundamental difference.



A. With respect to the risk assumptions, there are no differences. The fundamentals are the same.

The modes of operation are different, of course.

Q. As a consulting actuary, do you consult on rates and rate structures with companies in the credit life insurance industry?

A. Yes, sir, we do.

Q. Are you familiar with rates, mortality experience, and other elements in the credit life insurance industry?

A. Yes, sir.

Q. When you are determining rates and other data, do [193] you tailor your recommendations to the individual company or not?

A. Generally speaking, in the life insurance business, including the credit life insurance, it is a matter of tailoring the company's operation to life within a given rate which is generally the competitive rate or going rate.

Q. Are all credit life insurance companies the same in their rate needs, in their finance needs, and in their actuarial needs?

A. No two companies would be the same with respect to these particular points.

Q. Would there be a difference between a small company as compared to a large company?

A. Of course, a considerable difference with respect to the points that you mention.

There would be a considerable difference in requirements as to the distribution of the premium dollar.

Q. Briefly explain that to the Court.

A. Well, the premium that you collect from the insurer is comprised of several elements. I do have a chart that perhaps might be more easily followed than my conversation, but essentially, for Company A, the ingredients of its premium totaling, let's say, a dollar, since we are speaking in terms of credit insurance, a certain percentage for claims and other premiums available for expenses, and other expenses available [194] for profit.

Another company might have a different distribution of its premium dollar, and if charging the dollar premium, as with the first company, would have a different percentage on each of those.

Q. Based on your actuarial experience, is there any absolute factor set aside that—set aside in each premium dollar for commissions or other similar elements?

MR. BOOHER: I object to that question as leading. It can be answered yes or no.

It is argumentative and leading.

THE COURT: I will let the witness answer the question. The objection is overruled.

THE WITNESS: Well, there is no absolute certainty when dealing with probabilities.

There is always a chance fluctuation that something will occur outside the realm of averages. This is particularly true in cases of smallness. The actuaries rely quite heavily on average premium rate. They take that into consideration in deciding whether a particular company can live within a competitive premium or going rate on the market.

It isn't sufficient, however, to rely on averages. My favorite illustration is that you might easily drown wading across the creek which is on the average six inches in depth.

As to small life insurance companies, in that [195] respect you must guard against two things, one being fluctuations due to small numbers, and another being due to catastrophic currencies.

By MR. ANDERSON:

Q. On your examination of the report of the First Life Security Company of Texas, have you considered all the elements which you have just described to this Court?

A. To the best of my ability.

Q. Based on this study and your experience, have you formed an opinion as to how much of the money received by First Life Security Company between the years 1954 and 1959 should be retained by that company to keep it on an actuarially sound basis?

THE COURT: Answer yes or no.

By MR. ANDERSON:

Q. What is that opinion?

MR. ANDERSON: I can get a very brief answer from him here, and then I suggest we then recess, and we explain it after lunch.

By MR. ANDERSON:

Q. What is your opinion?

A. The size and nature of the risk assumed by this com-

pany in relationship to its capital structure required it to retain every dollar that it could possibly do so.

Q. To stay on an actuarially sound basis?

[196] A. Yes.

MR. ANDERSON: Very well.

THE WITNESS: Not only to stay on it, but to attain it, and then maintain it.

MR. ANDERSON: Very well.

I suggest that we adjourn now for lunch, then, Your Honor.

THE COURT: Yes.

We will adjourn now, gentlemen, to resume at 2:00 o'clock.

[197] MR. ANDERSON: Mr. Eddy, will you resume the stand, please.

ARTHUR CROOKS EDDY

resumed the stand and, having been previously duly sworn, testified further as follows:

- DIRECT EXAMINATION (RESUMED)

By MR. ANDERSON:

Q. Mr. Eddy, you are still under oath, and for the record you are the same Mr. Eddy who was testifying this morning before adjournment; is that correct?

A. That is correct, yes, I am the same Mr. Eddy, and I am under oath.

Q. Would you please—strike that.

MR. ANDERSON: Read back the last question and answer so we can pick up the continuity of the question, Mr. Reporter.

(Record read.)

By MR. ANDERSON:

Q. In your study of the documents, facts relating to First Security Life Insurance Company of Texas, and policies issued by American National during this period of time, were [198] there any health requirements that you noticed that were necessary of the borrowers before they could take out this credit life insurance we were talking about?



A. No, sir.

Q. Was there any waiting period before the insurance went into effect?

A. No.

Q. What effect would this have, if any, upon mortality rates?

A. This is a form of very lax underwriting which would necessarily invite anti-selection, and also necessarily take into the insured risk group hazards or risks that were not as healthy as you might be able to get had you had selection.

Q. Would the effect be favorable or unfavorable on mortality rates?

A. This would tend to increase mortality rates, the likelihood of excess mortality.

Q. Explain to the Court what anti-selection means.

A. That is a term used in the industry to describe the arrangement whereby the insurer selects against the insurance company, having information which he thinks is important and may add to the mortality in his own particular case, or make his death or disability more likely than the underwriting rules perhaps that the company might anticipate.

Therefore, he sees a distinct advantage to buy [199] insurance under these conditions, whereas the company in its formal selection, not in the case of American National's policy here, but the normal protection procedures would try to exclude such people from their coverages.

Q. If I understand that, you mean a loan officer might sell his body with cancer—

MR. BOOHER: I object to that as being argumentative.

THE COURT: Why don't you ask him to give us an example as to what he means.

By MR. ANDERSON:

Q. Give us an example of what you were just talking about.

A. In case of credit insurance, there would be two cases of anti-selection, one from the policyholder himself, and this was and has been a concern in the credit insurance industry, that the borrowing public would become more sophisticated and knowledgeable about the opportunities with respect to credit life insurance coverages, and this has been indicated in studies that have been made that such is the case, that



individuals who have terminal illnesses frequently borrow money in order to get this insurance protection.

Another example of anti-selection that play in the credit insurance field is where the individual who is running the financial institution, let's say a banker, is in a position to select against the insurance carrier himself, [200] knowing his friends in the community who may be less than standard health risks, and suggesting to them to borrow.

**Q.** Does the size of volume—does the volume written by an insurance company have any effect on the company's actuarial position and, if so, what?

**A.** The volume of insurance in force has a considerable effect, because the probability is that you use or assume in rate-making or contrary the amount of monies you assume from a given premium available for mortality purposes, depend upon large numbers.

Chance fluctuations against small numbers of insureds or small amounts of insurance outstanding can occur and, therefore, destroy the averages.

**Q.** Would a small company or a company the size of First Security Life of Texas be in a favorable position with respect to this matter that you have just commented on?

**A.** Security Life of Texas has over the period of five years been gradually-changing.

It is still at the end of 1959 a relatively small company with a considerable amount of risk, but with a chance of fluctuations not anticipated in the averages, at the outset it was very susceptible to.

**Q.** What about geographical area? Does that have any effect on actuarial position of the company?

**A.** With respect to credit insurance risks, the [201] concentration would be important. For instance, the catastrophes are more likely to occur with your clients who are all clustered in one small geographical area, for instance the disaster of Texas City is one.

This is definitely my opinion, that because of the relative concentration among its insureds.

**Q.** Have you expressed the opinion that Security Life needed the money that it took, and all of the money it took in, to stay on an actuarially sound basis? Have you prepared some charts which would help to explain to the Court the basis for this conclusion?

**A.** Yes, sir, I have.

**MR. ANDERSON:** With the Court's permission, I would

like to have the witness step down from the stand to demonstrate these charts.

THE COURT: Permission granted.

MR. ANDERSON: Your Honor, we have marked these charts ourselves Exhibits 58 through 63. They were exchanged with Government counsel yesterday.

We will move for their admission into evidence after this testimony.

(The documents referred to were marked for identification as Petitioners' Exhibits Nos. 58 through 63, inclusive.)

THE COURT: Do you have a copy there?

[202] MR. ANDERSON: Yes, I will give a copy to the Court.

THE WITNESS: These are a little difficult to read and they might be easier to follow from the copies there.

THE COURT: Thank you.  
Proceed.

THE WITNESS: In the construction of a gross premium for life insurance benefit or conversely as is the case here in the use of the various pieces of the gross premium which you have to use or sell in a competitive market, you have to consider the various benefits and expenses and cost elements and this diagram, although not very clear from these charts, are much clearer there, demonstrate the composition of the gross premium that should be charged for credit life insurance.

The three major elements are the benefits paid, investment income, which is really more appropriate for other types of insurance and expenses and profit margins.

The benefits break down into basically death and disability claims and withdrawal benefits. The death claims—or death claim benefits then can be further subdivided and it is in this subdivision that we find the main needs for retained earnings by a small and new life insurance company.

We have, first of all, the immediate claims.

These generally are the claims that you expect, based on the averages that you use as a mathematician.

[203] These are generally derived averages from studies of large groups of policy holders encompassing maybe as much as the large percentage of the entire insurance market.

Such may be the case in credit insurance, where the studies reveal that the average claim rate taking all policy holders together is a certain percentage of a certain premium.

The next column which you can not read from the chart has to do with the future claims which result from an increasing age problem and an increasing anti-selection problem.

Further, subdivided in the claims are claims that occur as a result of chance fluctuations.

The latest study of credit life insurance companies reveals that the smaller the company, or companies, the more drastic the fluctuations and the more likely the fluctuations can occur and as the company grows, the less likely fluctuations might occur.

However, the latest study indicates that credit life in general, there are chances among fluctuations over the averages assumed by the entire industry of large credit life companies.

Finally, we have claims that might result as a result of catastrophic happenings such as we had at Texas City, the Texas City disaster and the flu epidemic of 1918.

These were fluctuations in claims due to catastrophes [204] not anticipated in our normal premium rates or our immediate assumed.

Now, the future claims can be further subdivided due to an increasing risk, can be subdivided against the ageing of the insured and the increasing anti-selection.

Back about the mid '50's with credit insurance there was considerable concern about this increasing anti-selection hazard and since that time many companies have protected themselves to the extent possible with a very loose underwriting procedure which is generally the case with credit insurance, but by including in their policies or certificates certain health questions or elimination clauses in the event that some pre-existing condition was present at the time that the man purchased his insurance.

In other words, they would not have paid the claim had he died of a heart attack if at the time he purchased his life insurance he had already known that he had heart trouble.

The ageing of the insured in the credit insurance field was another problem that was a fear much among the companies in the mid '50's and this fear well warranted.

The latest study statistically of claim rate shows a substantial increase in the claim rates based on broad averages, since the 1958 report, which the 1958 report included the experiences of 1955 and 1956 on this business.

The subsequent report covers experiences of 1960 and [205] '61 and it indicates that there is this ageing problem.

In spite of the fact that during this same period of time the industry has benefited by a tremendous influx of new and younger lives, for instance, about 1955 the credit insurance in force in America was in the vicinity of ten billions of dollars which in itself is quite a change since the real activation of credit insurance programs back in 1945 or 1946, at which time there was less than one billion dollars in force, but the gross since 1955 through 1965 has been even more spectacular and has gone from slightly more than ten billions in force at the end of '65 just short of sixty billions in force and this influx of new lives and younger lives is due to the change in the economic community in our opinion and in the change in the attitude towards borrowing, and the change in the attitude toward insuring or protecting the loans thus made.

Now, that essentially describes our view of the distribution of a premium.

Now, each of these squares that I pointed out in particular—well, I have charts also demonstrating how they specifically might apply in this case and which will further demonstrate the point.

Shall I carry on?

By MR. ANDERSON:

Q. Please, if you can, and I would ask you to make it [206] as brief as you can and yet make it meaningful to the Court.

A. With respect to the First Security Corporation, the First Security Life Insurance Company, they commenced business in 1954 with, as this chart shows, \$12,500 of surplus.

There is a typographical error here.

The retention should be down one line and the surplus should be down one line.

The surplus accounting at the beginning of '54 was \$12,500. At that time this company retained a maximum of a \$5,000 risk on an individual life.

It would have required, as you may see, less than three



extra deaths to have made this company insolvent during 1954.

In 1955, its retention was still \$5,000. And it would have required nine lives to have made the company insolvent.

You might also find it interesting to note that for Security Life in the year 1954 it would have only required three deaths of these maximum amounts and yet they had some 12,000 policy holders.

Now, to say that the reinsurance vehicle is anything other than a risk venture is to be naive and ignorant of the facts because clearly, if you can wipe out a company's surplus with three deaths, the chance fluctuation with a small group could easily occur.

[207] Q. Mr. Eddy, as you show further numbers on that chart, would you indicate to the Court insofar as you can, how many policy holders there were each year as compared to the number of lives it would take to wipe out that company if you have that?

THE COURT: I think that the record should show that we are talking about Exhibit 59.

THE WITNESS: All right, 59, yes.

A. In 1954, the number of—

THE COURT: Just a moment.

And your testimony prior to this chart was concerned with Exhibit 58. That's just for the record.

MR. ANDERSON: Thank you.

THE WITNESS: All right.

A. At the year end 1954 there were 12,500 and six policy holders. The following year nine deaths would have been sufficient to eliminate the surplus amount, nine extra deaths at the maximum amount.

The company had 27,594 policy holders. The following year, 1956, 28 deaths required to eliminate surplus, the company had 34,388 policy holders.

And so on, and in 1959, the number of policy holders were 36,416. And this graph was drawn to demonstrate the magnitude of the risk involved or the possibilities of financial disaster for this company due to chance fluctuations [208] and due to its small size.

By MR. ANDERSON:

Q. Could you relate that to a block on your chart 58 so that the Judge could relate 59 to 58?

A. Yes.

59 was intended to point out the problem in this square which refers to claims due to chance fluctuations and, of course, due, of course, to small numbers.

Q. Are you now moving to Chart No. 60?

A. Yes, sir.

Chart No. 60 is just shown to amplify the figures shown in the previous chart and to show the relationship of the total outstanding insurance risk of this company as compared to its surplus account.

In 1954 or by the end of 1954 the volume—beg your pardon.

This chart shows the average exposure during the year as compared to the surplus account at the end of the year.

I beg your pardon, again. To the average surplus during the year.

So at 1954 with an exposure of \$3 million, the company had \$22,000 of surplus.

In 1955 with the exposure of \$10 million, the company had a surplus of \$84,000 on the average.

[209] In 1959 with an exposure of \$40 million, the company had a surplus of \$40,000 on the average for that year.

This relates—or amplifies '59.

Q. Which block in '59? I mean '58?

A. The same one as the—the same one as before.

Q. This is an amplification of the same block on '58?

A. Yes.

Now, within the life insurance industry there is a very much used rule of thumb for new life insurance companies that is to establish it with capital and surplus of approximately 100 times its maximum risk on one life.

This is arbitrary and a rule of thumb, but it is also true that throughout the industry the amount that companies will retain on one life is closely in that neighborhood.

And here are a list of companies in 1955 and the capital and surplus accounts during that year or at the end of that year and the relationship in the final column of a single life—retention on a single life to that capital and surplus, the figure is very obviously—and this is just a sample of a couple of hundreds that we went through to determine what the business judgment of the insurance industry management considered to be a reasonable relationship.

The average for this group is about 62.62 which means it takes approximately a hundred and forty claims at

[210] the maximum amount to eliminate the capital and surplus account of these companies on the average.

Q. Can you relate this chart to Security Life of Texas?

A. Yes.

We are still referring to claims due to fluctuations, but now also in this and this would be more protection for a company against the catastrophic loss, so you might consider that this last chart which is No. 61 is in part a demonstration of the needs for capital funds, both to protect against chance fluctuations due to small numbers and also to protect the company's financial position against catastrophic losses.

Now, Exhibit 62 is to show for First Security Life over the period under consideration here the relationship of its capital and surplus account to a maximum retained on a single life.

As you see, in 1954 by industry standards or by industry averages, the maximum retention on one life was particularly high in comparison to its available funds.

Now, a company which has this arrangement should take every expedient that would allow it to increase its capital account, capital and surplus account, so that a chance fluctuation or a small disaster would not put it out of business.

Following the Security Life through the years '55 through '59, we find that they gradually did retain monies not needed for other purposes, for claims, expenses, to build [211] the capital and surplus account, so that they were by 1959 in a position to have a \$10,000 retention on one life.

I might add that it is also beneficial to the owners of a life insurance company to retain the maximum amount possible within its capital frame work on a single life, since to buy insurance protection from another is to share part of the potential profits.

Those charts then were to demonstrate the points made with respect to chance fluctuations and with respect to the catastrophic hazards.

There is another and maybe more important reason why in the credit life business, life insurance companies of all sizes, small and large, should retain more money for protection against future losses.

And this has to do with what has in practice been occurring within the industry.

Credit insurance was practically unused before 1945. The volume in force at that time was something like 365 millions



which was less than one-fourth of one per cent of the insurance in force in America.

Well, after 1945 and as the credit and consumer restrictions, consumer credit restrictions, were reduced and credit became more available, credit insurance was used in an increasingly large measure as we have already mentioned.

In 1955, 10 years later, it had gone from 300 million [212] to 10 millions and 12 years later, it had gone from 10 millions to 60 millions or thereabouts in force.

Well, during that period of time the industry has been struggling from trying to determine how to measure it to determine what true loss ratios are there to determine what type of regulation should be imposed to protect policy holders.

It has done it with very poor statistics.

The original study in 1958 by Mr. Biddle and other people was wasted on statistical information derived from annual statements of life companies who were in the credit life business, in the credit life files.

The first such annual statement containing such information was for the year 1955. The study reported in 1958 utilized the information from 1955 statements and the 1960 statements.

It is unfortunate so much emphasis was placed on the material and information derived from those statistics, since for one person, at least, I know how difficult it was for the companies, for the industry to supply meaningful information, having been responsible for trying to determine such information for the company I was with at that time.

Much has been done to improve statistics since then. However, we are still far short of adequate to tell us one thing that we are going to need to know as time goes on and that one thing is what premium rates or what average [213] claim rates or what claim provisions should we make for credit life, depending on age?

Now, in 1954—

Q. May I interrupt just long enough to point out for the record that you were referring to Exhibit 63 and your last minute or so of testimony has been relating to Exhibit 63; is that correct?

A. I guess so. I think I am going between Exhibit 62 and Exhibit 63, however, I am building to describe what this table is supposed to demonstrate.



The practice in the industry has been to sell an individual policy either on a group basis—single premium policy, either on a group basis or individual basis for one dollar a hundred and this premium was arrived at by some one, and I know not whom or how or why, but it was developed through a group concept and a group of concept and a group approach.

In the group insurance business a group writing life insurance company will look at one employer who has many lives and he will take each individual life at his particular attained age, calculate a premium adequate for that individual for the amount of insurance he has and for his age and likewise for all other individuals in the included group, add them together and divide by the total amount to determine what is known as the life average rate.

This life average rate then is charged to in [214] practice each employee in the group during the period in which this premium rate applies.

Once each year the group insurance company redetermines this life average rate. What they have recognized is the fact that people increasing in advancing age are more likely to die than the people who are the youngest in the group.

It has been known in group life insurance since 1920 that any given employer may have an increase in his premium rate as years go on because his particular group of employees are maturing.

They are ageing. And thus he can expect—and in this respect, this is a point well communicated within the life insurance agencies—all employees expect this.

Well, credit insurance evolved from a group concept and the one dollar represents someone's opinion as to the life average rate.

It was generally accepted and in fact during the '50's and since that time, except for states in which regulations have restricted the use of the premium rate to a lower figure, two dollars still generally is used.

The part of the confusion as to the adequacy or inadequacy of the one dollar rate has been this tremendous influx of new young lives and the increase in volume in this business.

We haven't had an opportunity though, in my opinion, [215] we will have an opportunity and that it is underway.

As a matter of fact, we will have an opportunity to see

these average claim rates increase and there is evidence now between the study which was conducted and reported in '58 and the study which was conducted and reported last year, there is a definite indication that this is at work and is in truth happening.

The claim ratios have increased. I don't recall the precise figure, but approximately 20 to 30 per cent during that period of time, which has been barely, well, the periods covered were only six years spread.

Now, this chart then was to take for First Security Life, one policy holder. He is a policy holder out in some agricultural community. He is a borrower at the bank in 1954. He is 45 years old.

Now, it just so happens on the average, the borrowers of First Security Life or First Security Banks or First Security Corporation were about 45 at that period of time.

The American National contract provides for terminations of benefits or coverage at attained age 65.

Now, taking what is on this chart and advancing the man from age 45 to age 65, this will reflect what is going to happen and what has been happening with respect to that one individual.

[216] The fact that we as an industry are completely uninformed as to the true rate of increase in this man's cost is because we haven't gotten the statistical information to enable us to keep track of claim costs by age.

We don't have this information. To keep track of that, we have to conclude that by deduction and otherwise.

However, taking the man at 45 and taking the 1958 CSO table mortality which was chosen deliberately, not to represent credit life insurance mortality rates, because credit life insurance mortality rates, as should be and have been experienced by companies issuing unrestricted policies, lacking underwriting requirements, lacking waiting periods, should be higher than the '58 CSO mortality tables.

The '58 CSO mortality table covers insureds' lives and examined lives during the period under which we have in consideration and that's roughly the period, the year 1954.

It is not only illustrative, but conservative.

Now, following this man, he goes to the bank and he borrows \$100. He stays in this position and as soon as he pays back the \$100, he goes back and borrows some more.

He constantly and continuously is renewing and staying

in this pool. We charge him \$1 a premium. Now, it is the—

THE COURT: You are talking about the \$100 man, not the 3,000?

[217] THE WITNESS: Excuse me.

For the 3,000, it would just be \$30.

THE COURT: Right.

THE WITNESS: Now, the fact that it has appeared until this date that the dollar premium was adequate, is to ignore what is really in practice developing in the credit insurance industry, and that is you have an increasing cost due to those people who have been in the pool for the longer period of time.

They are being subsidized today by younger people and larger numbers of younger people coming in and paying a dollar, but at some state at some time, in fact, it would probably be predictable that these claim ratios would have to increase within the next decade because of the slump in new births following World War II.

We are probably looking at a much reduced claim rate because of the influx of men in the economic society who were born during the War.

However, if you took a closed community such as a small town, of course, buying credit insurance from a local banker or some one else and remaining the clientele of that bank, eventually the dollar rate will be insufficient.

So that we do today is profit. According to our annual statement of accounting in 1954, when our men age 45 was that age, if he really had mortality in the average code [218] on that table, we had that area of profits.

Now, following that man until he retires, something has to change in our industry.

We are either going to have to say, "Well, we will cut him off when he gets above the buck," or we say, "We are going to raise the rates when the community gets above the buck, then we must save money now to offset losses then."

Anything else is a short term point of view. Anything else is less than realistic of the circumstances and the facts and the practice that is now generally under current in our society or in our insurance industry.

It seems to us that the problem of this ageing population is a very important consideration.



And that also if you had a stationary group, for instance, if you were the largest insurance company in the world, writing the most credit insurance than any other company and you had insurers from the youngest age to the oldest age and every year they all moved up with some new people moving in to fill up the spot so that every year the composition in the group was precisely the same, then you could say whatever your book profits were, were profits.

You could spend them and wouldn't have to worry about the future. Until that situation occurs with this particular industry, then you are not going to be sound and you are not going to be adequately providing for the long-term losses that [219] can be generated.

That, I think, covers the charts that I have here.

By MR. ANDERSON:

Q. I have just a couple of more questions and then we will terminate your examination, Mr. Eddy.

THE COURT: You may resume the stand, again, sir.

THE WITNESS: Thank you.

By MR. ANDERSON:

Q. Well, first, 1954, were mortality rates absolutely known in the credit life industry?

A. No, they were not.

Q. Were they fixed or variable?

A. Variable, of course.

It depended on the group.

Q. Have they ever become fixed?

A. Well, no. There isn't any such thing as fixed mortality. If your group is charged enough, your statistics are ample enough, you might be able to predict with reasonable accuracy what to expect from that same group in the future.

Q. What is considered adequate protection in the credit life industry against catastrophic hazards?

A. The industry hasn't set any particular standards, but the group insurance laws of some states, the group insurance laws of some states have required companies in the group insurance field, including the credit insurance, to accumulate a [220] catastrophic reserve equal to 50 per cent of one year's premium income.

The Federal Income Tax Law effecting life insurance companies which is the 1959 Act, also recognizes such re-



quirement by allowing a company to deduct a two per cent premium per year until it gets to this maximum 50 per cent of premium.

Whether or not the company sets up a liability or keeps the money in surplus, they are permitted to make this deduction, recognizing that catastrophes can and do happen.

Q. If First Security Life Insurance Company of Texas had paid out 40 per cent commission during the years 1954 through 1959, would it have been such that it would have remained in your expert opinion on an actuarial sound basis?

A. No, not for the amount of risk they had.

THE COURT: Did we admit these exhibits?

MR. ANDERSON: Petitioners offer for admittance into evidence Exhibits 58 through 63 for identification.

THE COURT: Any objection?

MR. BOOHER: No, your Honor.

THE COURT: They will be received in evidence.

(The documents previously marked for identification as Petitioners' Exhibits Nos. 58 through 63, were received in evidence.)

MR. BOOHER: I would like to qualify that and say however we do not have any objections to the illustrations [221] and the methods by which these exhibits have been prepared, we don't necessarily stipulate to the underlying fact shown in these exhibits.

THE COURT: Yes.

Cross-examination, Mr. Booher?

MR. BOOHER: No questions, your Honor.

THE COURT: Thank you, sir.

You may step down, Mr. Eddy. You are excused.

(Witness excused.)

MR. ANDERSON: Your Honor, we would like to have marked for admission into evidence three charts that were used by Petitioners in their opening statement.

That would be the chart shown in the corporate family group, both before and after the split-up and the business transaction in question.

These would be marked, I believe, —we have two other charts which we have not yet offered and may not—

Exhibits 66, 67 and 68. We move for their admittance into evidence.

THE COURT: Any objection, Mr. Booher?

MR. BOOHER: No objection, your Honor.

THE COURT: They will be received.

(The documents referred to were marked for identification as Petitioners' Exhibits Nos. 66, 67 and 68 for identification and were received in evidence.)

[222]. THE COURT: Why have you jumped from Exhibit 63 to 66?

Are you planning on introducing 64 and 65 later?

MR. ANDERSON: Depending upon Mr. Tookey's testimony, we may have exhibits which we would like to introduce in rebuttal testimony, but that depends on what Mr. Tookey testifies to and we have numbered these other exhibits already.

THE COURT: Yes. I wanted the record to show it. Proceed.

MR. ANDERSON: That concludes the Petitioners' case.

THE COURT: Mr. Booher?

MR. BOOHER: The Respondent calls Mr. Clarence Tookey as a witness.

#### CLARENCE H. TOOKEY

was called as a witness on behalf of the Respondent, and, having been first duly sworn, testified as follows:

THE CLERK: Take the witness stand, sir, and for the record, sir, may we have your name?

THE WITNESS: Clarence H. Tookey, T-o-o-k-e-y.

THE CLERK: And your address, please?

THE WITNESS: My home address is 711 Craig Avenue, La Canada, California.

THE COURT: I think we will take a five-minute recess at this time.

(Short recess.)

[223] THE COURT: Back on the record. Please be seated.

Proceed with your direct examination, Mr. Booher.

## DIRECT EXAMINATION

By MR. BOOHER:

Q. Mr. Tookey, what is your present occupation?

A. Consulting actuary.

Q. What are your duties as consulting actuary?

A. Giving advice to clients regarding rates and their activities in the insurance business.

Q. What experience and training have you had as a consulting actuary?

A. I have been a consulting actuary since I retired from Occidental Life Insurance Company on June 1st, 1961.

Q. What title did you hold when you were last employed by the Occidental Life Insurance Company?

A. Senior vice-president.

Q. What title did you hold prior to that of senior vice-president?

A. Actuarial vice-president.

Q. What is the nature of Occidental Life Insurance Company's business?

A. They write life insurance and personal disability insurance on a group basis and on the individual basis on the lives of people in all of the states of the United States, [224] except New York and all the provinces of Canada.

Q. Did you have any responsibility in setting the rates charged by Occidental Life Insurance Company on its insurance?

A. I did.

Q. Was it the practice of Occidental Life Insurance Company to have its actuarial department set those rates?

A. It was.

Q. Do the initials NAIC mean anything to you?

A. National Association of Insurance Commissioners.

Q. Have you been on any industry committees?

A. Yes, on a great many.

Q. Could you briefly list those committees?

A. I was on the Joint Group Committee.

I was on the committee for the New Mortality Table which was named the 1958 CSO, CSO standing for Commissioner Standard Ordinary.

I was on the Credit Insurance Committee which was a joint committee appointed by the American Life Convention and the Life Association—the Life Insurance Company of America.

And I was on a number of other committees as well as that, special committees.

We had a committee that dealt with the principles that should be followed in writing a group insurance.

We had committees that dealt with the agents who thought there was too much insurance being written on the group basis rather than on an individual basis.

[225] I think those are the main committees that I served on.

Q. I believe you referred to the Credit Life Insurance Committee.

What was the origin of this committee?

A. It was appointed by the American Life Convention and the Life Insurance Company of America to study the credit business and perhaps set down some rules.

The origin of it was certain hearings that have been held—some federal hearings and some state hearings where the percentage of the premiums being charged debtors or borrowers was so small that there was suspicion that the lenders were using the excess to get around the usury laws.

And the reason the insurance associations took this up was that they wanted, if possible, to work out some kind of rules or agreements so that the insurance business would not be tagged with the criticism that had been made regarding the very low loss ratios that were occurring under creditor life insurance.

Q. Did I understand you to say that the percentage charged borrowers was so small?

A. It was the percentage of the premium charged borrowers returned in claims that was so small.

Q. I see.

Does the phrase "CSO" mean anything to you?

[226] A. Well, that is what I mentioned a moment ago.

It is the Commissioner Standard Ordinary and it is the adjective describing the table of mortality that is now in general use for valuation of liabilities of insurance companies.

Q. Would you please tell us something about the Occidental Life Insurance Company, your experience with this company and the manner in which rates were set by this company?

A. Well, rates were set by the actuary in the actuarial department.

Of course, the actuary always had a staff that did some



of the work, but he was responsible for authorizing all rates.

Q. Now, based on your experience, would you tell us briefly what rates, if any, we could characterize as commonly used rates in the credit life business between 1955 and 1959?

A. I think we would have to divide the business into two sections.

Under the business written on individual policies, the common rate was \$1 for each \$100 of indebtedness repayable in 12 equal monthly installments.

The other section of the credit life business was not as uniform as that because it was mostly written on group contracts and the rates would range all the way from slightly [227] over enough to pay the claims to perhaps as high as \$1 per thousand in some cases.

However, the average rates under the group policies were much lower than the \$1 a thousand.

Q. Did Occidental Life Insurance Company ever use a dollar per hundred rate while you were an officer of that corporation?

A. Yes, we did.

Q. When did Occidental Life begin operating in the credit life insurance business?

A. I think it was approximately 1932. Our first very large case was on the personal loans made by the Bank of America and in that case the bank was paying for the entire cost of the insurance out of the interest margin.

There was no charge being made to the borrowers. So that I forget what our rates were. This was our outstanding balance plan. The dollar rate we have been talking about is a single premium rate and that would amount to about \$1.50 a month if you had it on the outstanding balance plan.

I think that our rate may have been six or seven cents. It was rather unimportant because we kept only 15 per cent at the beginning, returned any balance to the bank because they had advanced the entire cost and then later we dropped our retention to 10 per cent.

Q. What did that 15 and 10 per cent represent?

[228] A. What Occidental kept to pay taxes and cover its operating costs and also a substantial profit.

Q. And that sum was after the payment of claims, I assume?

A. That's correct.

Q. In your experience in the life insurance industry, was it common for lending institutions to ask for compensation for an insurance company for selling life insurance to their debtors?

A. I think it was fairly common, yes.

THE COURT: May I hear that question again, please, Mr. Reporter?

(Record read.)

MR. ANDERSON: May I ask that to be limited to a time? This gentleman has been in the business for some years as I understand it and his experience with credit life was around 1930.

THE COURT: If you want it limited, that's fine.

It is all right by the Court, as the way it stands now, the question and answer doesn't mean anything. So if you want it limited, fine, because it doesn't mean anything to the Court.

He may be talking about 1890 or 1960, but that is my observation and it is your case.

[229] By MR. BOOHER:

Q. In your answer to the last question, what specific period of time were you referring to in your answer to the last question.

A. I would say that it covers the time from the middle 1930's to the present date.

Q. Does the phrase "reversed competition" mean anything to you?

A. Yes, it does.

Q. What does this phrase mean to you?

A. I will illustrate it this way.

I will imagine that I am making a proposal to the lender and I will propose to the lender that I will use 75 cents instead of \$1 and I will give the lender a 30 per cent commission so that the lender will get 30 cents out of the 75 cents as a commission.

My competitor goes to the lender and he says, "I charge \$1, but I pay 50 cents —" I mean, 50 per cent commission, "so that you will make 50 cents on each unit of insurance instead of 30 cents."

Now, normally competition is on a question of price. And

normally my 75 cents would have gotten the business as against a charge by my competitor of \$1.

However, if it is based on the return to the lender where he is getting 50 cents instead of 30 cents as a [230] commission, he may decide to accept the higher rate because of the higher commission and that is where the phrase regarding "reversed competition" came in.

Q. In connection with your work in the insurance business, and the connection with the setting of rates, is the phrase—or the term "representative cross-section" of any significance?

A. Well, I think that all that that would mean would be, do you have a—if it is connected with an actuarial concept—do you have a homogeneous risk?

In other words, you have a group. Has it the same average age, the same average mortality and so forth as white males in the United States? That might be one use of the expression "representative cross-section."

Q. Does the population of a particular state such as Utah or Idaho, contain a representative cross-section of individuals from an actuarial standard for life insurance purposes?

A. I think so because the premiums charged by companies doing business in all states would be the same in those states as they would be in New York, New Jersey or in California.

Q. Now, sir, have you made a study of the operations of the First Security Life Insurance Company of Texas in connection with its credit life, health and accident insurance for the years 1955 through 1959?

[231] A. I did, based on the figures that were furnished to me by the staff of the Internal Revenue Service.

Q. In your opinion, what profit did Security Life realize on credit insurance sold to borrowers to the First Security Banks during the years 1955 through 1959 which was reinsured with Security Life?

MR. ANDERSON: This question is speculative.

I object. It calls for a conclusion that is not within the expert opinion of this gentleman's knowledge, since it refers to just profits.

What profit did they make? Now, what profit did they make is a very ephemeral factor, if I may say so.

Profit is profit. He is going to say that they took in



some money but some of it wasn't profit, maybe a question could be asked that maybe some of the money they took in wasn't profit or something, but what profit did they make is entirely vague and speculative.

THE COURT: I am going to permit the question and on cross-examination you can bring out the—

MR. ANDERSON: Well—

THE COURT: You can bring it out on cross-examination. Proceed.

THE WITNESS: Approximately one million dollars on the credit accident—life and accident and health business.

By MR. BOOHER:

[232] Q. How did you arrive at this opinion?

A. Well, I first took the amounts that have been paid in those years on the life and accident and health credit business, including a figure of approximately 228,000 and some odd in the form of unearned premium reserve and then I had to translate that into the premiums that were charged the borrowers.

The reason I had to do that was that the premiums received by the First Security were met of approximately 50 per cent that had been held out of the gross premiums by American National for their services.

In addition to the 15—that gave me a figure of approximately one million, nine hundred and fifty thousand dollars. I am leaving off the cents for simplicity.

The claims amounted to approximately \$524,000.

Claim expense amounted to about \$1800; the administration charge of American National, \$202,500; and for taxes and general expenses, I had to prorate.

I found that the credit life and accident and health premiums were approximately 80 per cent of the total, so that I took 80 per cent of the total taxes and expenses which amounted to \$20,363 and 80 per cent of that was approximately \$16,339.

This gave me a total charge, expenses and claims of [233] \$834,000 so that the company had left over about \$1,115,000.

However, out of that, they had to set up their reserves. And those appeared to be approximately \$106,000 so that I get a figure for the net profit of about \$1,008,000.

Q. Now, sir, assuming a commission of 40 per cent of the net premiums paid by borrowers was paid on the credit life, health and accident insurance sold to customers of the



First Security Banks during the years 1955 through 1959, what was the amount of such commission paid and the amount of underwriting profit to First Security Life?

A. Well, 40 per cent of the gross premiums received from creditors which were approximately 1,950,000, 40 per cent of that is approximately 880,000.

So when—that is 780,000 rather.

So when that is deducted from 1,008,000, we get approximately \$228,000 that would have been the profit if 40 per cent commission had been paid on the gross premiums charged to borrowers.

Q. What is your basis for these opinions as to the reasonableness of a 40 per cent commission?

A. Well, commissions ran on this dollar rate all of the way from 40 to more than 60 per cent.

The average commissions are shown in the investigation made by the insurance commissioners to which Mr. Eddy referred some time ago and 40 per cent is lower than the average [234] commission paid on the dollar rate, but we have to keep in mind here that we have American National's profit in that administration charge, so that having allowed American National a profit, the First Security wouldn't have been able to pay 50 or 60 per cent commission and still have shown any underwriting profit.

Q. Is your opinion on these matters based on your experience?

A. Primarily. I have worked—I have a number of clients that are in the business of credit life and accident and health. I was exposed to it for many, many years while I was with Occidental and I have been fairly active in the field.

It was largely at my urgings that we got the credit insurance law passed in the State of California which requires that the premiums be reasonable in relation to the benefits granted, and the dollar rate is no longer legal in California.

The maximum rate in this state now is 75 cents.

Q. And am I correct in understanding that what was stated in the report merely corroborates your opinion based upon your experience?

A. That's correct.

Q. Now, sir, what in your opinion is the normal method of an insurance company protecting its surplus?

A. Well, one way is not to take on too great a risk for

[235] the surplus that it has available. And many companies reinsure a substantial amount of their business because they don't feel that their surplus and capital are sufficient to justify a large retention on any one risk.

Q. Now, in your experience, sir, is it normal or customary to start an insurance company with \$12,000 in capital?

A. Not in most states of the United States.

THE COURT: What year are you talking about?

MR. BOOHER: During the years 1955 through 1959, sir.

MR. ANDERSON: We ought to amend that.

It is 25,000 capital, \$12,500 surplus.

By MR. BOOHER:

Q. In your experience, was it normal to start an insurance company during the years 1955 to 1959 with an initial capitalization of \$25,000?

A. No, it was not, in any state that I know of, except Arizona and Texas and I believe it was done in those two states.

California, at that time required \$500,000 of capital and surplus.

Q. How long did the insurance reinsured by First Life Insurance Company of Texas during the years 1955 to 1959 run?

[236] MR. ANDERSON: I would like a clarification of the question, your Honor.

I don't know whether he is talking about the maximum provided for in the policy or whether this is experience derived from the actual bank data or what it refers to.

THE COURT: I think you better for my benefit get an answer to a question that is meaningful.

Do you want the question to stand? I will overrule the objection but—

By MR. BOOHER:

Q. In your study of the data furnished you concerning the First Life Insurance Company of Texas concerning the operations of this study for the years 1955 to 1959, what was the duration of the credit life, health and accident insurance reinsured by this company?

A. I only know from hearsay. I did not study their business.

MR. ANDERSON: Then I object to it.

THE COURT: There is no answer. He doesn't know.

MR. ANDERSON: Very well.

THE COURT: If there is another question, then your objection will be proper, or I will sustain your objection.

By MR. BOOHER:

Q. Have you prepared a report which illustrates the methods and procedures that you used in arriving at your [237] opinions that you have just given?

A. I have prepared a report from which I have just read the figures which I have given.

THE CLERK: For identification, Respondent's Exhibit CK.

(The document referred to was marked for identification as Respondent's Exhibit No. CK.)

MR. BOOHER: I offer Respondent's Exhibit CK for identification into evidence as Respondent's Exhibit CK.

MR. ANDERSON: I would like to address myself to the motion just made by Respondent's counsel.

This was what was offered to us last night for examination. The Court will notice on the face of the report, the first page, that there are questions stated which are in the form of legal questions and these are statements in there that—phrases in there, used to the effect that the companies involved in this case are not dealing at arms length.

The term "arms length" which is a legal term arising under 482 is a legal conclusion in and of itself and the inferences in this report all are based upon this phrase.

Whether this expert feels that these people are dealing in arms length is not material. It is not within his expertise as an actuary. He is not qualified to state a conclusion as to whether businesses are dealing at arms length or not. We feel that it is materially prejudicial.

[238] The second objection that I have to the report other than the fact that it uses these legal phrases which state the conclusions of law and which are outside the ambit of this man's expertise, is at pages—well, they are not numbered on my copy, but they would have three, four, and five of the report, and they are based upon a simple mathe-



mathematical calculation, derived from an industry average table, provided for in a 1958 study.

And the objection to this particular aspect of the report is two-fold:

The first part of the objection is that the report is hindsight. The figures used in order to support Mr. Tookey's opinion were not made available to the industry until 1958.

We are talking about a company that was formed April 1st, 1954.

Now, the gist, in essence, of this report is that of a valuation report and a common rule in this Court as in other courts is that data after the date of valuation cannot be used, except in a corroborative manner.

The second aspect of the objection is that it is not directly responsive and relevant to the First Security Life Insurance Company of Texas. This is a mathematical calculation induced from a broad field to arbitrarily apply to one small company rather than deducted back.

[239] We feel that in that respect it is irrelevant. So for these three reasons, we would object to the report.

It may resolve the first objection if the Court is reminded of the fact that Mr. Tookey has just stated he has read his figures into the record.

Well, based upon the figures he has read into the record, the report is now before the Court and it is without the prejudicial language that I am objecting to, so counsel cannot complain that the figures and computations were not before the Court and the only thing that would be left in the report would be Mr. Tookey's phrasing of the questions presented and his conclusions in the legal manner.

THE COURT: Off the record.

(Discussion off the record.)

THE COURT: Back on the record.

Any further observations?

MR. BOGGER: Your Honor, these comments of Petitioners' counsel go merely to the weight of the testimony as to the meaning of the term, "arms length."

Every expert who testifies in any type of valuation matter, must make some determination as to the relevancy of some comparative data.

To say something is or is not at arms length is a matter of opinion, but it is certainly not a legal conclusion.

As to this point, I am not sure I recall what counsel [240] is really referring to as a conclusion of law in this case.



Certainly Mr. Tookey is testifying as an expert actuary and not as a lawyer.

As to the report, using hindsight, he specifically testified that he based his opinion on experience.

This data was merely corroborative of his experience for which reasons I submit that the comments by Petitioners' counsel go merely to the weight of the opinion and not to the admissibility of the opinion or the report in evidence to illustrate the facts, methods and procedures that he used to arrive at this opinion.

THE COURT: Yes. The Court feels that all of your objections do go to the weight and your observations are on the record and they will be considered.

MR. ANDERSON: Very well, your Honor.

THE COURT: The exhibit marked for identification as Exhibit CK is admitted into evidence.

(The document previously marked for identification as Respondent's Exhibit No. CK, was received in evidence.)

THE COURT: Do you have anything further, Mr. Booher?

MR. BOOHER: I have nothing further.

THE COURT: You may cross-examine, Mr. Anderson.

[241] CROSS-EXAMINATION

By MR. ANDERSON:

Q. Mr. Tookey, when you use a phrase, "arms length," is that a personal opinion or do you derive that from a book or a rule that we can cite to the Court?

It is a personal opinion, isn't it?

A. Well, I think it has a layman's meaning as well as a legal meaning—

Q. I am not asking the meaning.

MR. BOOHER: The witness has not had an opportunity to finish answering the question.

MR. ANDERSON: I am asking that he be responsive, if we can't get an answer to that question.

THE COURT: Let that question and answer stand and come forth with another question and see what develops here.

You can go back to this again. I am not precluding you from doing that.

MR. ANDERSON: I will argue with—I will argue it on brief.

THE COURT: I think it is a matter more for brief, yes.

MR. ANDERSON: Yes.

By MR. ANDERSON:

Q. Page 3 of your report, Mr. Tookey, refers to Volume 1 of the 1958 proceedings of the National Association of [242] Insurance Commissioners.

Are the statistics derived following that statement on Page 3 taken from that report, sir?

A. You refer to the wording, "Page 128 shows the following averages for 1955 and 1956," is that it?

Q. Correct.

A. Those were taken from that report.

Q. You testified in local finance versus commissioner, a case before the tax court last summer, isn't that correct, sir, as a witness for the Government?

A. Yes.

Q. This report we just alluded to is the same report that was referred to in this colloquy on Page 332 of the transcript of those proceedings, stating—by Government counsel—"Question: Let me ask you this. Your opinion, sir, was it formed because of what was in that report you are talking about?"

"Answer: No, it was not."

Is that the same report?

THE COURT: Did you follow that?

By MR. ANDERSON:

Q. Does that sound familiar to you? Your opinion in the local finance case regarding Grand National was not based on this report, was it?

A. No, it wasn't.

[243] Q. You stated that your opinion in this case was based upon your experience in the industry.

To refresh your memory, on Page 332 and 333 of the local finance transcript—

MR. BOOHER: If he is going to impeach the witness for prior inconsistent testimony, he should be giving the witness an opportunity to read this testimony before putting the question to him.

MR. ANDERSON: I will be happy to give him the transcript.

By MR. ANDERSON:

Q. Follow along with me, sir, and as I read—

A. Yes.

Q. Line 24—or 25 says, "Answer: One experience was studying the statements of several companies that have been almost 100 per cent, if not a hundred per cent in the credit insurance business.

"One of those companies is Grand National. Another of them was Alinco."

You testified for the Government in the Alinco case, too, did you not, sir?

A. That's correct.

Q. And going down to Lines 12 and 13, "Another source is a client of mine who writes practically nothing but creditors insurance and has a premium of around \$8 million a [244] year.

"I know what his experience is."

Were these the companies you used to make up your experience in arriving at your conclusions, sir?

MR. BOOHER: Let me specify which opinion it is he is talking about, the one in this case here or the one in the case we have today?

MR. ANDERSON: The one in the case we have today.

By MR. ANDERSON:

Q. Are these the companies that you used in arriving at the opinion in your experience in the case we have today?

A. My opinion as an actuary?

THE COURT: That is a question which is going to require a yes or no answer.

Were these companies used at all in arriving at your opinion here today?

THE WITNESS: To some extent, yes.

By MR. ANDERSON:

Q. Were there other companies used in arriving at your opinion here today?

A. Possibly the First Security, after I received the figures on them.

Q. Any other companies?

A. (No response.)

THE COURT: Are you thinking or—

[245] THE WITNESS: I am thinking because I have a lot of clients and—is the question only with respect to my experience since I have been consulting?

THE COURT: Now, Mr. Tookey.

He is asking—he wants to know what you used in arriving at this conclusion, what companies? Now, you have stated you have used the same companies, that is, that you used in the prior report plus First Security and now is there any other company?

You should know that. Did you use any other company?

THE WITNESS: Perhaps I am confused, your Honor, but I am being asked my conclusion. I would like the conclusion read so I am sure of what I am being asked.

THE COURT: Your conclusion in this case?

THE WITNESS: My report in this case. All I gave in the report that is in evidence is a mathematical study of the figures that I was given on First Security, together with a quotation of figures that were published in this book of proceedings by the National Association of Insurance of Commissioners.

By MR. ANDERSON:

Q. Thank you.

Mr. Tookey, referring again to that report, I direct your attention to Line 21 on Page 333 of the local transcript [246] and tell me where the statement made on that line and the following line refers to the report you just made or the report you just identified. "Frankly, this report here is not in such shape that it can be used for anything except to see if in a large block of figures if there is any difference."

Does that refer to the same report that you just identified?

A. I would think so from reading it.

Q. Do the function of an actuary to make sure that there is virtually little or no risk for the policy holders of a company that the actuary is setting rates for?

A. No risks for the policy holders.

Q. No risk for the policy holders, is that the purpose in setting rates?



MR. BOOHER: I object to that question as being too vague and indefinite to produce an intelligible answer.

Risk, in what sense of the word?

MR. ANDERSON: Risks that they will not be covered, I suppose.

MR. BOOHER: Covered in what sense? That the claims will be paid timely?

MR. ANDERSON: I submit the question for ruling.

THE COURT: Read the question again, Mr. Reporter.

(Record read.)

THE COURT: Can you answer that?

[247] THE WITNESS: I think he should set the rates so that his company won't go bankrupt and theoretically be unable to pay off its obligations.

By MR. ANDERSON:

Q. What mortality or claim figures did you use in your report in arriving at your conclusion for this case?

What claim experience did you use, what figure?

A. If again, this opinion is the report that is entered in evidence, those are the figures of First Security.

Q. Mr. Tookey, would you have known those figures at April 1, 1954 or is this hindsight?

A. Well, I don't believe that I made any comment about what rate I would have set at the time if I have been setting the rate in 1954.

Q. Was there any guarantee in 1954 that First Security Life Insurance Company of Texas would not have losses greater than 30 cents on the dollar? Is there any absolute actuarial guarantee that that would not happen?

A. I don't believe an actuary can guarantee anything.

Q. In your testimony in the Alinco Life Insurance Company case, did you hear Mr. Stover testify that the overall loss for Old Republic Insurance Company was 38 cents on the dollar?

Do you remember that testimony?

A. I had forgotten that.

[248] Q. Do you know that American National Life Insurance Company has 50 cents loss on the dollar in the State of Utah?

MR. BOOHER: I object to that question.

It has not been established in evidence as yet that this is a correct figure of American National—

MR. ANDERSON: I am testing the witness.

THE COURT: It is proper. It is on cross-examination. Answer the question, sir.

THE WITNESS: By that question, do you mean that on this dollar rate that we have been talking about, that the losses were 50 percent?

By MR. ANDERSON:

Q. Fifty cents on the dollar claim experience in the State of Utah, the state we are talking about in this case?

A. No, I did not know that.

Q. Do you know that Standard Life and Accident Insurance Company in the State of Utah has loss experience of 58 cents on the dollar rate for credit life and 54 cents on the dollar for accident and health?

A. No.

Q. Is there any guarantee to a life insurance company of any size that they would not suffer losses of this magnitude?

A. The probability is remote and—

Q. The answer is, is there any guarantee that they would not suffer losses of this magnitude?

[249] A. I presume not, if an atomic bomb hit down or they lost one of those nuclear War Heads why—

THE COURT: Your answer is no?

THE WITNESS: That's right.

By MR. ANDERSON:

Q. Do you know that if it is established in evidence that American National is suffering a 50 cent loss rate in the State of Utah, that there has been a nuclear War Head on the State of Utah in the last little while?

MR. BOOHER: I object to the last question and ask that it be stricken.

MR. ANDERSON: I withdraw it.

By MR. ANDERSON:

Q. You just testified that the purpose of an actuary is to protect policy holders on risks.

MR. BOOHER: He did not so testify.

By MR. ANDERSON:

Q. Is one of the purposes for—or of an actuary to protect policy holders from risks in setting rates?

A. I think the job of the actuary is to estimate what reserves and what rates should be charged, so that the company will be solvent and be able to pay off its obligations.

I believe it is the insurance commissioner whose responsibility it is to see that the reserves are set up on a proper basis.

[250] The code in the State of California will not permit premiums to be charged below a certain basis without setting up reserves in advance.

I don't feel that the actuary has the responsibility of the financing of the insurance company entirely.

Q. Well, then, let me put it in another way and make sure that this is before the Court.

Is one of the responsibilities of an actuary to make sure that the rates keep the company in a safe position?

A. I don't know whether he can make absolutely sure of that. He uses probability, history, and rates that should with proper operation of the company, keep it solvent.

The actuary cannot prevent foolish operations on the part of the company management, such as losing money on their sales effort and so forth, so I don't see how the actuary can take the final responsibility of keeping the company solvent.

THE COURT: I think that the answer is probably yes. Isn't it, Mr. Tookey?

Don't you think that the actuary has some responsibility?

THE WITNESS: He has some, but not the total responsibility.

THE COURT: Does that help any?

MR. ANDERSON: Let's see if this helps some more.

[251] By MR. ANDERSON:

Q. Page 329 of the transcript of the local says thus and so and read your testimony about that and maybe it will help some, beginning with Line 24.

A. Well—

THE COURT: The witness doesn't realize that these are different volumes of the testimony.

THE WITNESS: What page am I supposed to be on?

By MR. ANDERSON:

Q. Excuse me, Page 379 of the transcript, sir.



A. I see.

Q. This is your testimony and this is your answer on Line 24.

"Answer: Not necessarily minimum rate. I don't think when I was an actuary charged—I charged a minimum rate. I wanted the rate to be safe for the company."

Now, would that statement stand true as your opinion in this court today as it was in local finance?

A. That is correct, but I couldn't guarantee that it was sufficient. There is a difference in my opinion—

THE COURT: Now, Mr. Tookey, wait a minute.

There is only one question before you and that question is, do you agree now with the statement you made then, am I right, Mr. Anderson?

MR. ANDERSON: That's right.

[252] THE COURT: Now, it takes a yes or no answer, Mr. Tookey, and then if you wish to amplify your answer, you may, but the Court wants you to answer that yes or no.

THE WITNESS: I would say yes, but may I now amplify it?

THE COURT: Yes.

THE WITNESS: That in the phrase, "The rates to be safe for the company," it is a rate that in my opinion and based on my experience and all the risks involved is most likely to produce a profit for the company and not to cause it a loss.

By MR. ANDERSON:

Q. Assume with me, Mr. Tookey, that we have in evidence or will have in evidence the fact that there is a large life insurance company, American National, suffering a 50 cent loss rate in the State of Utah today on one dollar a hundred premium.

Let's apply your figures to this, a 50 cent loss. What was the retention to American National given by First Security Life, what percentage?

MR. BOOHER: We are talking about 10 years ago.

That deals with today. If he can go back to '54 or '55, it might have something to do with this case.

By MR. ANDERSON:

Q. Could the 50 cent loss rate happen at any time?

[253] You said before you couldn't guarantee what the loss rates would be. Haven't you said that?



A. The probability of a loss rate changing materially in a short time is extremely remote.

Q. Is it there?

MR. BOOHER: If I may, your Honor, the Court has not yet ruled on my objection.

It is irrelevant.

THE COURT: The objection still stands, but I want a little more information here before I rule.

By MR. ANDERSON:

Q. Is the problem—or probability still there?

A. I—a possibility, not a probability.

Q. Let's follow these figures.

THE COURT: I am going to overrule your objection. I am going to let him testify. He is on cross-examination and I think that the objection should be overruled.

By MR. ANDERSON:

Q. Let's follow these figures then, Mr. Tookey.

What was the retention to American National by First Security Life in this case during the years 1954 through 1959?

A. 15 per cent.

THE COURT: That would be 15 cents on the dollar, is that right?

THE WITNESS: That's right.

[254] By MR. ANDERSON:

Q. What was your suggested reallocation figure in your report?

MR. BOOHER: I will object to this line of questioning.

It is apparently to develop a comparison between this company and American National on a 50 cent loss ratio. The facts are that this company upon which Mr. Tookey based his opinion did not have a 50 cent loss ratio.

If you assume a greater loss ratio, you are going to come out with a profit—

THE COURT: He is an expert. He knows this field and I think Petitioner has a right to attest the amount of foundation or strength of the opinion given by the witness. And this is all that he is doing. I think it is proper.

Your objection is overruled.

By MR. ANDERSON:

Q. What does the amount of the reallocation you suggest in your report—or the so-called unearned part of First Security Life's income? 40 per cent; is that right?

Don't you know what your report states?

A. I don't know what you are talking about, counsel. You have lost me.

Are you asking about the claim reserves?

Q. No.

[255] A. Or the small allocation of the expense that I made here for claim expense and pro rata tax in general?

Q. Your report starts out talking about assuming a 40 per cent reallocation.

MR. BOOHER: The report does not state a 40 per cent reallocation.

THE COURT: What does it state?

By MR. ANDERSON:

Q. What is the reallocation percentage?

MR. BOOHER: The report does not tell—or deal with a reallocation.

THE COURT: Let Mr. Tookey answer, Mr. Booher.

I have to evaluate what this witness's opinion is worth.

By MR. ANDERSON:

Q. Let me direct your attention to Page 2, "Percent of commission if 40 per cent had been paid." Is that correct?

A. That is merely a comment, your Honor.

Q. Is that—it is the basis for your figures and conclusion, isn't it?

A. Well—

THE COURT: Answer the question. He asked, it is a basis for your conclusion, isn't it?

THE WITNESS: I am confused as to semantics here.

My conclusion—all I have done is put down the [256] mathematical figures here that would result as near as possible.

I showed the experience for five years and then merely said, "If 40 per cent had been paid."

THE COURT: The answer to the question is yes then.

I mean that is what the Court is concluding for the purpose of this record from this testimony.

By MR. ANDERSON:

Q. Adding up then a 50 cent claim experience, a 15 cent retention, a 40 cents so-called commission out of the one dollar premium rate, how much do we have the company paying out?

Please, give me that total?

A. A dollar and five cents.

Q. Would that leave the company safe and solvent?

Would that be a rate safe for the company?

THE COURT: Assuming that set of circumstances?

THE WITNESS: No, it wouldn't; assuming those circumstances.

THE COURT: Well, I think we better give the reporter a break here.

We have been moving pretty fast.

We will recess for five minutes.

(Short recess.)

THE COURT: Back on the record.

[257] Be seated, please.

Resume the stand, Mr. Tookey.

By MR. ANDERSON:

Q. Mr. Tookey, you made some statements on direct examination regarding "reversed competition."

Now, in states where premiums are competitive and the company in question is charging the competitive premium, is there any reversed competition?

A. I wouldn't think so on the business. I don't believe it goes by states, but on the business where the premium is—the amount of premium determines who gets the business, then, there would be no reversed competition.

Q. In other words, if it is a standard rate, there is no reversed competition, is that it?

If it is a standard accepted rate, it is not reversed competition?

A. Well, if it were in a situation where the lender, if it was the lender that was taking out the policy or the seller, if it was a vender taking out the policy, who wanted the lowest rate that would give the insurance coverage, I don't believe there would be a standard rate because I think the various insurance companies would compete with one another.

They would try to assess that particular piece of business

and they would set their rates, based on their judgment of that piece of business and it would not be a standard level rate for everyone.

[258] Q. Would you kindly turn to Page 371 of the local finance transcript? It is in the smaller volume.

Do you have it?

A. Yes. That's the one I have.

Q. Line 10; were these questions propounded to you and were these your answers?

"Question: Is this higher compensation to an intermediary what you would call reversed competition, Mr. Tookey?

"Answer: I don't believe so, because we had to charge the same rates of premiums and be competitive with all the New York companies, because we were out in the open market.

"Question: In other words, if a premium rate doesn't change, then, there isn't any reversed competition?

"Answer: No, I don't believe so."

Were these your answers, sir?

A. They were.

Might I explain—

Q. I would like to go on and ask another question.

Please turn to Page 326 of the local transcript, sir. That's in the big volume.

A. The big volume?

Q. Yes.

A. I have it.

Q. Line 22; was this question propounded to you and was the answer that followed, your answer?

[259] "Did you have occasion during that time to consult publications and to meet with experts and other representatives of the credit life insurance industry with respect to rates and credit life insurance?

"Answer: Not particularly."

Was that your answer, sir?

A. Correct.

Q. Have you read volume 17 of the transactions of the Society of Actuaries of 1965?

A. No, I have not.

Q. Are you familiar with the fact that there is a study in the credit life insurance industry which supercedes the 1958 report which you referred to in your report?



A. I know there was the 1961 and '62 experience, I believe, that was reported in the proceedings, the 1964 proceedings, Volume 2 of the Commissioner's proceedings.

Q. This is a later report?

A. That's correct.

Q. Than the 1958 report?

A. That's correct.

Q. Are you familiar with the fact that on Page 329 of that report there is evidence that on—there are statistics shown that on units—that on creditor units—

MR. BOOHER: I object to this question.

If he wants to determine whether the witness is [260] familiar with the statistics, he can hand the witness the document and the witness can say, "I am familiar with it or I am not familiar with it."

As it is now, he is reading into the record these facts.

MR. ANDERSON: I am testing the witness to see if he is familiar with the existence of certain facts.

MR. BOOHER: If he wants to find out if he is familiar with the facts, give him the document and the witness can say yes or no, so that matter which is not in evidence will not be read into the record in this case.

MR. ANDERSON: This man here is an expert, your Honor.

THE COURT: I am going to let him proceed. If these matters are in the record, I am not going to pay any attention to them unless the witness says, "I am familiar with it."

If he is not familiar, then that fact also will go to the same weight. It is just like saying, are you familiar with anything in the volume? If he says, "No," then that's going to the weight too.

MR. ANDERSON: We can offer it later.

THE COURT: You may proceed.

By MR. ANDERSON:

Q. Are you familiar with the fact that this study shows that there were over 2,000 creditor units suffering a claim [261] experience of 50 cents and higher?

MR. BOOHER: If I may—

By MR. ANDERSON:

Q. That is on the sale of credit life insurance?

THE COURT: I don't think this witness is familiar with anything there, is he? Because that is a study—

THE WITNESS: Your Honor, I do have—

THE COURT: Just a moment.

I think what you better do—I don't know what you have in front of you. You better give it to the witness and ask him if he is familiar with anything in it because we could go all night on this.

MR. ANDERSON: The point made originally was whether he was familiar with the later study than the one he quoted.

THE COURT: Is that the report you have? He stated that he hadn't read that report?

THE WITNESS: I didn't state that, your Honor.

By MR. ANDERSON:

Q. Have you read the 1965 study, Volume 17, the proceedings of the Society of Actuaries?

A. I have not read that. I knew that that report had been made. However, the report made to the Commissioners, I have read the original reports that were in typed form. I have not seen the printed form which is a proceedings like this.

However, I have right here in my briefcase, copies [262] of the typed report and I remember distinctly that there is a table in there, showing how many, how much of the business ran above 50 cents and how much of it ran down and on one of those tables, counsel may remember that the credit union showed something like 20 cents or 20 deaths.

Q. The credit union business is the best in the industry?

A. It is the best because I merely mentioned—

Q. Your report placed into evidence, does this note the twin dollar or borrow by check or mortgage placed into the First Security Life Insurance Company of Texas during the years 1954 through '59?

A. No, I was not asked for a report on those.

Q. Isn't the reason for that that the loss experience on those lines was as high as 120 per cent on twin dollars, 80 per cent on mortgage, isn't that the reason?

A. According to the figures I had, it was not that high, but I would have to go through my file here.

Q. Weren't the loss ratios considerably higher?

A. They were higher.

MR. ANDERSON: That is all I have.

You may asked on redirect, Mr. Booher.

**REDIRECT EXAMINATION**

**By MR. BOOHER:**

**Q.** In your report on Page 2, you show a commission of [263] \$780,059.79.

In your opinion, would this have been a reasonable commission to be paid on the credit life, health and accident insurance for reinsurance to the First Security Life Insurance Company of Texas during the years 1955 through 1959?

**MR. ANDERSON:** We are not talking about commissions, we are talking about a life insurance company and what it needs.

This is irrelevant.

**MR. BOOHER:** This goes to the weight of the testimony. This is our theory of the case. The Court can give such weight to it as it desires.

**MR. ANDERSON:** In addition, this is not redirect. This is beyond the scope of my cross-examination, since I didn't examine him on this point.

**MR. BOOHER:** My understanding of the direct examination, and I can be wrong on this, is that we cannot cover this—my understanding was that I did cover this. Then in reviewing the cross-examination, there was some confusion on the record, apparently, as to whether this was merely a mathematical calculation.

So, it is proper redirect examination, and if it is not proper redirect examination, then in the interest of justice, I request the Court grant me authority to cross-examine on those. It will be no injustice to the Petitioners [264] whatsoever.

**MR. ANDERSON:** This report has been admitted over your objection. That report, if it does not speak for itself, certainly should.

This is all counsel for Respondent should ask for. This is improper redirect.

**THE COURT:** Normally, it would not be proper redirect examination, but I think under the procedure that the Court urges here, I am going to let the question stand and permit an answer to it, but at the same time I am going to permit to that answer a different weight than I might give to it if it had come in the ordinary course.

THE WITNESS: I think it is a reasonable rate of commission, although it is lower than the average commissions that were paid during that period on this type of business.

By Mr. BOOHER:

Q. Your report also shows an underwriting profit of \$228,785.29.

In your opinion, would this have been a reasonable underwriting profit on the credit life, health and accident insurance reinsured with the First Security Life Insurance Company of Texas during the years 1955 through 1959?

MR. ANDERSON: Same objection, your Honor.

THE COURT: Same ruling.

You may answer.

[265] A. I think it is reasonably, particularly taking into account the fact that American National is already taking a profit in their administration charge.

MR. BOOHER: I have no further questions, your Honor.

THE COURT: Any recross-examination?

MR. ANDERSON: Nothing further of this witness, your Honor.

THE COURT: Thank you, Mr. Tookey, you may step down. You are excused.

(Witness excused.)

THE COURT: Do you have another witness, Mr. Booher?

MR. BOOHER: No, your Honor, we do not.

THE COURT: Are you resting?

MR. BOOHER: The Respondent rests, yes.

MR. ANDERSON: We have rebuttal witnesses, your Honor.

THE COURT: Call them, please.

MR. ANDERSON: May I have a moment, your Honor?

THE COURT: Yes.

MR. ANDERSON: I call Larry Harlan, please.

THE COURT: Off the record.

(Discussion off the record.)

THE COURT: On the record.

[266] Regarding the stipulation of facts, the clerk has pointed out that there is apparently an admission on the — is that the supplemental stipulation?

MR. WATSON: No. This is the basic agreed to stipulation with the joint exhibits. And apparently by inadvertence, Exhibit BZ 51(3) was omitted.



**THE COURT:** Fine, gentlemen. It is received in evidence and the stipulation will be amended to show the addition of that exhibit.

You can do it either by typing or writing it in on the original and conforming the copies.

(The document referred to was marked for identification as Joint Exhibit No. BZ(51) (3), and was received in evidence.)

**W. LARRY HARLAN**

was recalled as a witness on behalf of the Petitioners, and, having been previously sworn, testified further as follows:

**THE COURT:** This witness has already been sworn, is that right?

**MR. ANDERSON:** Yes.

**THE COURT:** Proceed.

**DIRECT EXAMINATION**

**By MR. ANDERSON:**

**Q.** You were the same Larry Harlan who was testifying previously in this proceeding, are you not?

[267] **A.** I am.

**Q.** You are still under oath?

**A.** Yes.

**Q.** Would you tell the Court what the claim loss experience on one dollar a hundred credit life insurance was in the State of Utah for the last two years?

**A.** The latest available figures we have was 47 cents the first year and 50 and six-tenths the second year.

**MR. ANDERSON:** I have no further questions.

**THE COURT:** Cross-examination?

**CROSS-EXAMINATION**

**By MR. BOOHER:**

**Q.** Does that pertain to the years 1966 and 1967?

**A.** 1964 and—wait a minute—1965 and 1966—wait a minute.

It is 1964 and 1965 figures. We do not have '66 figures available as yet. And they are on file with the State of Utah and the Utah Insurance Department.

**THE COURT:** So those figures are in 1964 and '65?

**THE WITNESS:** Yes.

**MR. ANDERSON:** No further questions, your Honor.

**THE COURT:** Any further cross?

**By MR. BOOHER:**

**Q.** Do those figures relate solely to insurance sold to the customers of the First Security Banks?

**[268] A.** No, sir. This is all the business we have in force in the State of Utah, but it is all on the dollar rate.

**Q.** Is this on group policies the same as were in effect during the year 1954?

**A.** Yes, sir.

**MR. BOOHER:** No further questions.

**THE COURT:** You are excused.

. . . . .  
**RESPONDENT'S EXHIBIT AQ**

First Security Corporation, Largest Intermountain Banking Organization, 79 South Main Street, Salt Lake City, Utah, February 10, 1959.

Thomas F. Hawkes, Vice President & Comptroller.

Mr. W. L. Harlan, Manager, Credit Insurance Division, American National Insurance Company, P.O. Box 8067, Dallas 5, Texas.

Dear Larry: On December 30, 1958, we forwarded a letter to you asking what would happen in the event the Reinsurance Treaties executed by the Officers of the American National and the First Security Life Insurance Company were cancelled. We received your letter dated January 2, 1959, in which you indicated that an agency contract would be executed with an agency of our selection whereby American National would pay a commission on any accident and health premiums being held by American National.

You also mentioned in your letter that you would be in Salt Lake City toward the end of January and I delayed making any further inquiries thinking that we could discuss the matter more fully when you were here. I understand you came to the office but were forced to leave in about 30 minutes because of some other pressing business. I was quite disappointed that I did not see you but we think the question should not be dropped at this time and that a definite understanding should be reached.

It was not stated in your letter of January 2nd, as to whether your letter pertained to all treaties or to just Reinsurance Treaty No. 2 covering Accident and Health coverage written on instalment borrowers in our "Time-way" Department.

Article VIII in the Reinsurance Treaty covering Real Estate Mortgage Loan Borrowers reads as follows:

"First Security shall have the right to cancel this treaty at any time by giving American National 30 days prior written notice of such cancellation. Notice mailed to American National at P.O. Box 8067 Dallas 5, Texas, shall constitute notice as provided herein.

In the event this treaty is cancelled by First Security as above provided, all outstanding certificates previously issued by American National hereunder shall cease to be reinsured with First Security as of the date of cancellation of the reinsurance treaty."

This refers to both Life and Disability coverages and in discussing the treaty with certain other officers, they state that Article VIII is not according to the understanding reached when the original arrangements were made.

We feel that we should be in possession of a letter from American National clarifying the situation as to what would happen should the reinsurance treaty be terminated.

I do not wish to appear super technical, but believe that our files should be complete in respect to this matter. Perhaps a letter or an agreement covering all business originating with First Security, that is, instalment loan, mortgage and "Twin Dollar" and not limited to any one division, would be in order.

Very truly yours,

THOS. F. HAWKES  
Vice President

TFH:mj

First Security Bank Of Idaho, National Association;  
First Security Bank of Utah, National Association; First  
Security Bank of Rock Springs, Rock Springs, Wyoming.

#### RESPONDENT'S EXHIBIT AR

Credit Insurance Division, American National Insurance  
Company, P.O. Box 8067, Dallas 5, Texas.

COPY

January 2, 1959

Mr. George S. Eccles, President, First Security Bank of Utah, N.A., Salt Lake City, Utah.

Dear George: I have before me the new reinsurance treaties executed by the officers of American National and First Security Life.

In the event these reinsurance treaties should at some future date be cancelled it is understood that an agency contract will be executed with an agency of your selection whereby American National pays a commission on any accident and health premiums being held by American National.

For very good reasons, this matter cannot be mentioned in a reinsurance treaty, and I will cover this point with you the next time we can get together. Incidentally, I am going to the West Coast sometime around the 20th of January, and I am planning on coming back by Salt Lake somewhere around the 1st of February, provided you are in Salt Lake at that time. Please drop me a note as to what your traveling plans are between the 28th of January and the 5th of February.

Sincerely,

W. L. HARLAN

WLH:lwc

## RESPONDENT'S EXHIBIT AS.

First Security Corporation, Largest Intermountain Banking Organization, 79 South Main Street, Salt Lake City, Utah, December 30, 1958.

Thomas F. Hawkes, Vice President & Comptroller.

Mr. W. L. Harlan, Manager Credit Insurance Division, American National Insurance Company, P.O. Box 8067, Dallas 5, Texas.

Dear Larry: We return to you herewith two copies of each of the new treaties forwarded to us with your letter dated December 23, 1958.

The question came up when the new treaties were being signed as to whether a clause should be inserted in Reinsurance Treaty No. 2 to cover the payment of commissions



should the ceding of premiums be discontinued to the First Security Life Insurance Company. This, of course, would also apply to the Mortgage contract.

We are also wondering if it is necessary that the signing of these contracts be authorized in the Minutes of a Director's Meeting.

Very truly yours,

/s/ Tom

THOS. F. HAWKES  
*Vice President*

TFH:nj

Enclosures

RESPONDENT'S EXHIBIT BE-37

Minutes Of Meeting Of Executive Committee

First Security Corporation—April 1, 1954

A meeting of the Executive Committee of First Security Corporation was held in Salt Lake City, Utah, April 1, 1954 at 10:30 A.M.

Present: George S. Eccles; M. S. Eccles.

George S. Eccles acted as Chairman of the meeting, with M. S. Eccles acting as Secretary.

First Security Life Insurance Company Of Texas

The Chairman stated that for the past several months consideration had been given to the incorporation of an insurance company for the purpose of writing credit life insurance in connection with our Consumer Credit Department as well as to write term insurance in connection with mortgage loans. He reviewed briefly the advantages of such a plan, including tax savings on premium income, and the fact that a life insurance company incorporated under the laws of Texas, may own an office building. By organizing our own company we would be qualified to either insure or reinsure.

The committee authorized the management to proceed with the incorporation of an insurance company to be known as. "First Security Life Insurance Company of Texas" to be incorporated under the laws of the State of Texas. Paid in capital to be in the amount of \$25,000.00 with surplus of \$12,500.00. The officers of the company to be as follows:

George S. Eccles—President and Director.

D. Owens Thurman—Vice President, Asst. Secretary & Director

Rulon E. Jones—Vice Pres., Asst. Treas. & Director

J. D. Evans—Vice President and Director

V. R. Steffensen—Vice President and Director

Thos. F. Hawkes—Secretary, Treasurer and Director

S. J. Quinney—Director

It is anticipated that the new bank and office building being erected at Fourth South and Main Streets in Salt

Lake City may be carried in the name of the insurance company.

### First Security Savings And Loan Association

The Committee discussed the organization of a Savings and Loan Association to operate at various points in Utah. It was felt that in view of the favorable tax provisions affecting such concerns and in view of our extensive activities in mortgage loan financing as well as the favorable competitive position Savings and Loan Associations are in, due to the higher interest they are able to pay because of tax benefits, it would be advisable to incorporate a Savings and Loan Association under the laws of the State of Utah.

The management was authorized to file incorporation papers and apply for approval from the State Banking Department for the incorporation of "First Security Savings and Loan Association", with the purpose of establishing branches at Provo, Ogden, Salt Lake City and Sugar House. The new company to have authorized capital of \$250,000.00 of which \$25,000.00 would be subscribed at the present time. Officers of the company to be as follows:

V. R. Steffensen—President and Director  
 S. R. Neilson—Vice-President and Director  
 C. Verl Benzley—Secretary, Asst. Treas. and Director  
 Thos. F. Hawkes—Treasurer, Asst. Sec. and Director  
 S. J. Quinney—Director

### Federal And State Taxes

The Chairman presented a schedule of Federal and State taxes paid for the year 1953 by First Security Corporation and its affiliates.

Company	Federal	State	Total 1953	Comparison 1952
First Security Bank Idaho— Normal & Surtax	817,288.27	79,303.93	896,592.20	1,024,564.81
Excess Profits	—0—			
First Security Bank Utah— Normal & Surtax	1,097,309.65	45,097.71	1,176,925.36	1,137,175.19
Excess Profits	34,518.00			

Company	Federal	State	Total 1953	Comparison 1952
Rock Springs First Security Corp.	28,402.26	—0—	28,402.26	20,020.89
First Security Co.	119,828.03	—0—	119,828.03	106,963.64
First Security Bldg. and Loan	74,503.22	2,656.49	77,159.71	68,053.78
First Security Ins. Agency	—0—	—0—	—0—	—0—
Ed. D. Smith & Sons	14,357.20	1,379.07	15,736.27	19,752.05
Idaho Investment Co.	30,211.69	1,561.00	31,772.69	19,920.12
Western Investment Co.	1,434.28	—0—	1,434.28	1,632.41
	11,208.35	1,395.49	12,603.84	2,767.22
	<u>2,229,060.95</u>	<u>131,393.69</u>	<u>2,360,454.64</u>	<u>2,400,840.06</u>

### Construction Of Bank And Office Building Salt Lake City, Utah

The committee discussed the proposed contract to be entered into with Utah Construction Company for the construction of the new twelve-story bank and office building at Fourth South and Main Streets in Salt Lake City. The management was authorized to enter into a contract with the Utah Construction Company for said purpose on a cost-plus-fixed-fee-basis to provide for a construction fee in the amount of \$150,000.00, (to be payable \$12,500.00 per month). The construction fee is based on an estimated cost of \$2,500,000.00. The contract to further provide that in the event the cost exceeds \$2,500,000.00, the Utah Construction Company shall receive 7½% of the amount of the excess.

There being no further business, the meeting was adjourned.

Chairman

M. S. Eccles  
Secretary



**RESPONDENT'S EXHIBIT BV-45**

**Commissions Paid to Ed. D. Smith & Sons by Credit Life of Springfield and American Bankers Life For Their Respective Years For the Period 1949-1954.**

**These amounts were reported, respectively, as Taxable Income by the First Security Company on the Tax Return of the First Security Company For Each Year Indicated.**

<b>1949</b>	<b>\$ 3,682.88</b>
<b>1950</b>	<b>5,886.80</b>
<b>1951</b>	<b>20,327.42</b>
<b>1952</b>	<b>41,240.10</b>
<b>1953</b>	<b>60,343.74</b>
<b>1954</b>	<b>15,884.37</b>

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# PETITIONERS' EXHIBIT 53

## EXAMINER'S COMMENTS

### Resources

All loans and discounts  
Overdrafts  
Premium on Bonds  
Bonds, securities, etc.  
Banking house  
Furniture and fixtures  
Other real estate  
Cash items  
Shortages  
Other (specify)

### Reserves

Exhibit No. **B3**

140.29

11.83

173,269.36

1,917.56

175.14

TOTAL

Was request made that the estimated losses be charged off? **Yes.**

Were the entries made during the examinations? **No. To be charged off when authorized by Head Office.**

VERNAL

### EXAMINER'S COMMENTS ON MATTERS REQUIRING ATTENTION

(Include comment on items in previous report of examination which have not been satisfactorily adjusted)

Considerable increase in classified assets is noted at this examination, in addition to a heavy volume of Other Loans especially mentioned. Several illegal real estate loans are also noted, all of which indicate a general relaxation of policies. Local growth conditions are partially responsible for the volume of criticized assets.

### INSURANCE AGENCY

The branch operates an insurance agency in violation of Paragraph 11, Section 13, Federal Reserve Act, and has done this since the branch was acquired. The Insurance Department sells a complete line of life insurance, accident insurance, etc., and the personnel of this department also act as regular branch personnel, with one individual appointed Assistant Branch Manager, and an active member of the loan committee. These personnel are included in the branch payroll, and income from their operations goes directly into branch earnings. This violation of law should be removed as soon as possible.

### INSURANCE DEPARTMENT

EXCERPT from Bank's L-107 dated 4-2-63.

In the loan review, Mr. (letter J. Parleton brought our attention to what he thought was a violation of Paragraph 11, Section 13 of the Federal Reserve Act in connection with our insurance department. He stated that our insurance department was in violation because of the fact that in interpreting this Section that the Head Office was a place that the population figure should be based on. Our last census of Vernal shows a population of 3,612 and this Section of the Act indicated that banks cannot have an insurance department if the town in which they act in is more than five thousand population. Therefore, I feel that this criticism is unjustified in as much as we have been acting under this law every since it came to Vernal and before that and that the law is based upon the town in which the insurance is sold and the insurance is sold in Vernal, Utah and not in Salt Lake City, therefore, I think this criticism by the bank examiner is unjustified.



107. Review

In creditor's action to enforce judgment against newly chartered national bank to which assets of debtor bank had been transferred where creditor's counsel expressly stated that liability was sought to be imposed on theory that there had been a merger of debtor bank and new bank and case was tried on that theory, issue of whether transfer of assets by debtor bank to new bank was made in contemplation of insolvency was excluded and could not be considered on appeal. *Pankay v. Hot Springs Nat. Bank*, 1941, 119 F.2d 634, 46 N.M. 10.

Where on appeal from judgment dismissing national bank receiver's action

against receiver of state savings association for value of alleged assets of bank pledged to association receiver and transferred by him under district court's order, bill of exceptions, settled by stipulation did not contain record of evidence pertaining to transactions relating to pledge of assets and their subsequent transfer, or statement that record contained as much of evidence as was necessary to explain alleged errors, court could not consider questions whether assets were pledged as security for a loan or deposit, or whether bank was owner of assets at time of transfer and whether, therefore, transfer was valid. *Tobin v. Seaborn*, 1938, 32 P.2d 744, 55 Neb. 432.

§ 92. Acting as insurance agent or broker; procuring loans on real estate

In addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which such bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent; and may also act as the broker or agent for others in making or procuring loans on real estate located within one hundred miles of the place in which said bank may be located, receiving for such services a reasonable fee or commission: *Provided, however*, That no such bank shall in any case guarantee either the principal or interest of any such loans or assume or guarantee the payment of any premium on insurance policies issued through its agency by its principal: *And provided further*, That the bank shall not guarantee the truth of any statement made by an assured in filing his application for insurance. Sept. 7, 1916, c. 461, 39 Stat. 753.

Notes of Decisions

Authorization of agency 1  
Guaranteeing loans 2  
Revocation of license 3

1. Authorization of agency

This section expressly authorizes national banks in small places to act as agents for insurance companies, and hence contract of national bank in a village to procure insurance is not ultra vires. *Marshall Nat. Bank & Trust Co. v. Corder*, 1938, 194 S.W. 734, 169 Va. 608.

2. Guaranteeing loans

Under this section a national bank is prohibited from guaranteeing payment of principal or interest of loans notwithstanding loans are made on its own account and that, in selling notes secured by mortgages, it deals with its own property. *Genesee Trustee Corporation v. Smith*, C.C.A.Mich.1930, 102 F.2d 125.

A bank is prohibited by this section from guaranteeing payment of the principal and interest of a loan; and such prohibition is in effect violated where a national bank in selling a real estate



mortgage held by it enters into a contract for its repurchase whenever requested to do so. Moreover, although the bank has received the benefits of such a contract, it is not estopped, when sued thereon, from setting up as a defense the want of authority to make the contract. *Greene v. First Nat. Bank of Thief River Falls*, 1927, 215 N.W. 212, 172 Minn. 219.

### 2. Revocation of License

Action of state commissioner of insurance revoking license of Michigan corporation to write insurance as an agency was authorized by evidence, where it appeared that activities of Michigan corporation were controlled by a national bank, and that bank by indirection obtained license in name of Michigan corporation to evade Comp. Laws Supp. 1940, §§ 12330, 12344 and this section which prohibited bank from securing a license in its own name. *Washington Agency v. Forbes*, 1944, 16 N.W.2d 121, 300 Mich. 622.

## § 93. Violation of provisions of chapter; forfeiture of franchise; personal liability of directors

If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this chapter, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper district or Territorial court of the United States in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation. R.S. § 5239; Mar. 3, 1911, c. 231, § 291, 36 Stat. 1167.

### Historical Note

References in Text: Words "this chapter" in section, see note under section 21 of this title.

Codification. Act Mar. 3, 1911, cited in text, conferred the powers and duties of

the circuit courts upon the district courts.

Derivation. R.S. § 5239 derived from Act June 2, 1864, c. 103, § 52, 13 Stat. 116, which was the National Bank Act. See section 35 of this title.

### Notes of Decisions

- I. GENERALLY 1-30
- II. FORFEITURE OF FRANCHISES 21-30
- III. COMMON LAW AND STATUTORY LIABILITY OF DIRECTORS 31-120
- IV. ACTIONS AGAINST DIRECTORS 121-161

Generally 1-30  
 Abstention of actions 25  
 Absence of directors 30  
 Accrual of action 25  
 Actions against directors 121-161  
 Appointment of receiver 22  
 Bank and receiver 144  
 Bill of particulars 149  
 Common law and statutory liability of directors 31-120  
 Common law liability generally 31  
 Compromise or settlement 150

Conditions precedent  
 Adjudged violation 122  
 Demand upon shareholders 124  
 Forfeiture or dissolution 121  
 Receiver, refusal to sue 123  
 Construction 1  
 Damages  
 Distribution of 126  
 Interest allowance 127  
 Measure of generally 125  
 Delegation of duties 32-39  
 Committee 39  
 Supervision 39



EXHIBIT No. 56

October 17, 1955

Mr. W. L. Harlan, Manager  
Credit Life Division  
American National Insurance Company  
c/o P. O. Box 8067  
Dallas, Texas

Dear Larry:

From time to time I have discussed with you some of the other activities which are contemplated for First Security Life Insurance Company. You told me it might be a good idea to send in a report to our head office in Dallas, Texas. As I am not sure just whom I should be writing, I am sending this letter to you, with the hope that you will place it in the proper hands and see that I receive any necessary instructions. The following matters should be of interest to our head office staff.

Under date of January 4, 1955, First Security Life Insurance Company of Texas was authorized by the Federal Housing Administration, Washington, D. C. to act as an approved mortgagee under the provisions of Title II, Title VI, Title VIII, and Title IX of the National Housing Act. Our Certificate is numbered 19591 and is dated January 4, 1955.

In addition, under the direction of our general counsel, Mr. S. J. Quinney of Ray, Quinney and Nebeker, Kearns Building, Salt Lake City, Utah, we received approval to do an investment business in the State of California. One of the principal reasons for acquiring the right to do business in California, as well as becoming an FHA approved lender, was for the purpose of financing and servicing 196 individual mortgages to be made in Richmond, California pursuant to the provisions of Section 213 of the National Housing Act. Prior to the granting of the 196 individual mortgages, three separate blanket mortgage loans will be made on properties in Richmond, California by First Security Life Insurance Company, as mortgagee. These loans are identified as follows:



Project No. 1	\$841,350.00
Project No. 2	752,000.00
Project No. 3	538,100.00
Total	<u>\$2,131,450.00</u>

First Security Life Insurance Company of Texas appears as mortgagee on these mortgages, but has arranged to sell the following participations:

First Security Bank of Utah, National Association, Salt Lake City, Utah	24%
Bankers Trust Company, 16 Wall Street, New York, N. Y.	75%

This will leave the life insurance company with a 1% investment in the mortgages above referred to. Initial service charges of  $1\frac{1}{4}\%$ , amounting to approximately \$32,000.00, will be earned by the insurance company for negotiating this financing.

In addition to the initial service charges, the life insurance company will, besides receiving interest at  $4\frac{1}{4}\%$  on its 1% investment in the mortgages, receive a servicing fee equal to  $\frac{1}{4}$  of 1% on the participations held by others.

It is expected that the three blanket mortgage loans herein referred to will be superseded and replaced by 196 individual mortgage loans bearing interest at a rate of  $4\frac{1}{4}\%$  per annum. Arrangements have been made with the First Security Bank of Utah and Bankers Trust Company of New York to purchase the individual FHA mortgages which will emanate from this financing, with the servicing of the individual mortgages to be retained by the life insurance company at its office in Richmond, California, at a servicing fee of  $\frac{1}{4}$  of 1% per annum. In this connection, arrangements have been made with Utah Construction Company of Richmond, California, for quarters to house mortgage operations of the company in that area. Utah Construction Company will also furnish one or more employees to perform the servicing work of the company in that area. The insurance company will be billed monthly for this expense.

It is my understanding that all items of profit and expense are to be reported to our head office in Dallas at least monthly. In addition, as soon as mortgage loans are nego-



tiated, the detail with regard thereto is to be reported immediately to our head office in Dallas, Texas.

If there are any other suggestions or instructions regarding our proposed activities, please advise.

Very truly yours,

/s/ V. R. Steffensen,

V. R. STEFFENSEN,

*Senior Vice President.*

VRS/jmg

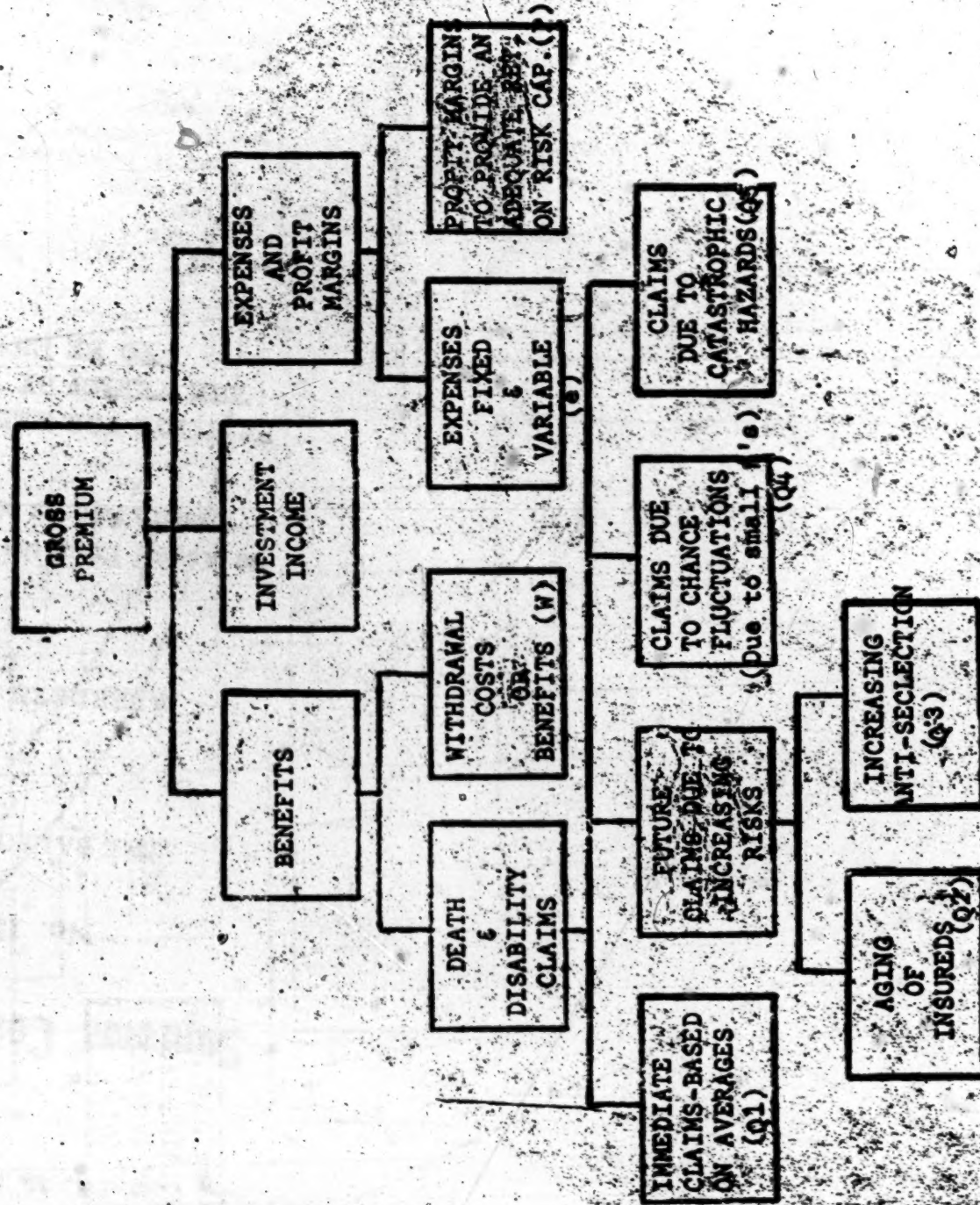
cc: Mr. Thos. F. Hawkes

CHART

EXHIBIT 58  
68

GROSS PREMIUM ELEMENTS

(Life & Disability Benefits)

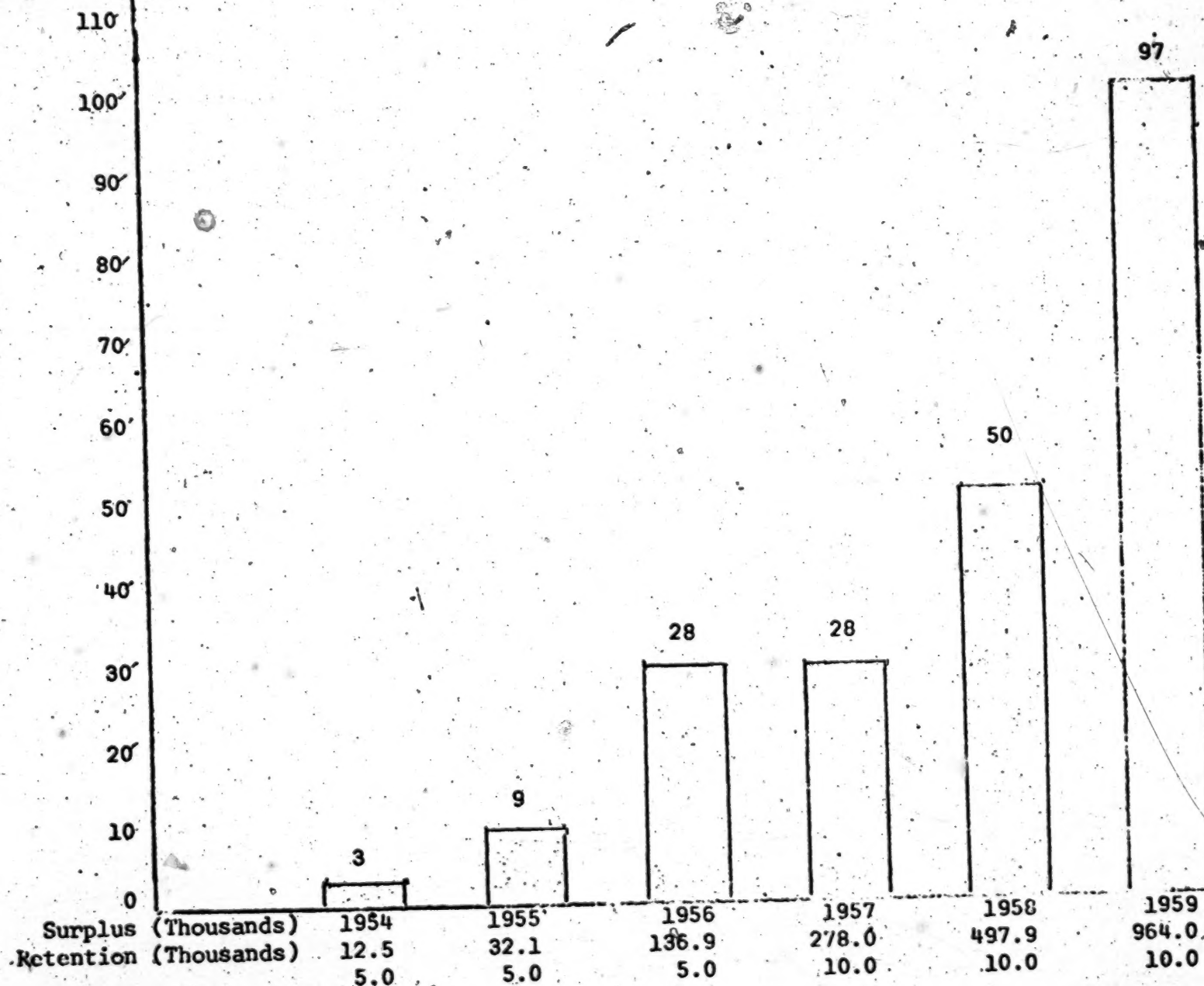


$$P + (Q_1 Q_2 + Q_3 Q_4 + Q_5) + W - I + S + P$$

# FIRST SECURITY LIFE INSURANCE COMPANY OF TEXAS

EXHIBIT 59

Number of Max. Extra Death  
Claims Needed To  
Eliminate Surplus  
At Beginning of  
Calendar Year

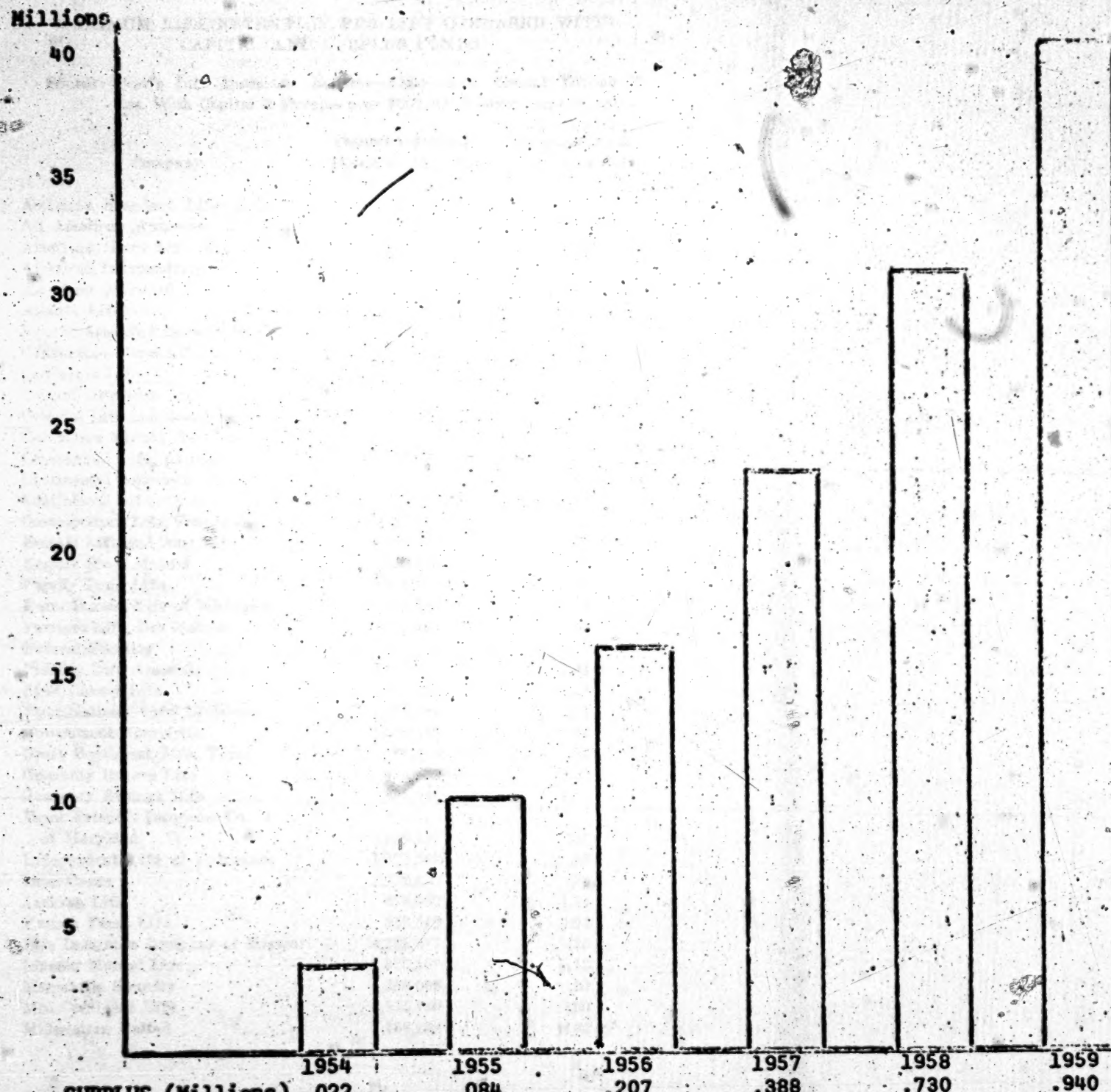


GRAPHS  
PETITIONERS' EXHIBIT 59



FIRST SECURITY LIFE INSURANCE CO. OF TEXAS  
AVERAGE AMOUNT AT RISK RELATED TO AVERAGE SURPLUS

EXHIBIT 60



GRAPH

PETITIONERS' EXHIBIT 60





# PETITIONERS' EXHIBIT 61

## MAXIMUM RISK RETENTION PER LIFE COMPARED WITH CAPITAL AND SURPLUS FUNDS

Source: Best's Life Insurance Reports—Fifty-first Annual Edition  
Cos. With Capital & Surplus over \$500,000 & Retention \$10,000

Company	Capital & Surplus December 31, 1955	Retention As A % of Cap. & Surp.
American Standard Life—D.C.	2,456,985	.41
All American Assurance of Louisiana	494,881	2.02
American Home Life, Kansas	858,444	2.79
American Independence Life	741,628	1.35
American Standard Life, Texas	871,868	1.15
Atlanta Life	11,749,963	.09
Benefit Assoc. of Railway Employees	4,516,199	.22
California—Farm Life	666,982	1.50
California Life	744,001	1.34
Central American Life	120,872	8.27
Colonial Life and Accident	1,912,434	.52
Columbian Mutual, Tennessee	301,065	3.52
Commercial Life, Arizona	709,647	1.41
Continental American, Texas	605,123	1.65
Continental Life, Texas	1,344,045	.74
Cosmopolitan Life, Tennessee	2,517,174	.40
Empire Life and Accident	3,076,729	.33
Empire State Mutual	720,407	1.39
Family Fund Life	913,036	1.10
Farm Bureau Life of Michigan	561,264	1.78
Farmers Life, Des Moines	791,467	1.26
Federal Security	620,125	1.61
Fidelity Life Association	2,463,292	.41
First Colony Life	421,008	2.38
First National Life, Louisiana	4,321,723	.23
Government Employees	1,028,329	.97
Great Southwest Life, Texas	721,478	1.39
Guaranty Income Life	441,433	2.27
Guaranty Savings Life	609,140	1.64
Home Friendly Insurance Co. of Maryland	2,696,198	.37
Independent Life of Baltimore	1,173,269	.85
Inter-Ocean	2,772,685	.36
Jackson Life	878,902	1.14
Kansas Farm Life	352,599	2.84
Life Insurance Company of Missouri	4,261,677	.23
Lincoln Mutual Life	1,375,107	.73
Mercantile Security	4,390,995	.23
Med-Continent Life	1,815,149	.55
Midwestern United	1,486,188	.67

Mutual Savings Life, Missouri	637,867	1.57
National Bankers Life	949,958	1.05
National Educators Life	530,016	1.89
National Farmers Union Life	752,367	1.33
National Home Life Assurance	1,169,547	.86
National Life of America	1,591,422	.63
National Life & Casualty	857,879	1.17
National Public Service	1,027,432	.97
Northeastern Life of New York	838,802	1.19
Northwestern Life	668,262	1.50
Old American Insurance	3,150,535	.32
		<u>AVERAGE</u>
	80,176,308	.62

**PETITIONERS' EXHIBIT 62**  
**FIRST SECURITY LIFE INSURANCE COMPANY**

Maximum Retention Expressed as a  
Percentage of Capital and Surplus as of  
the Following December 31

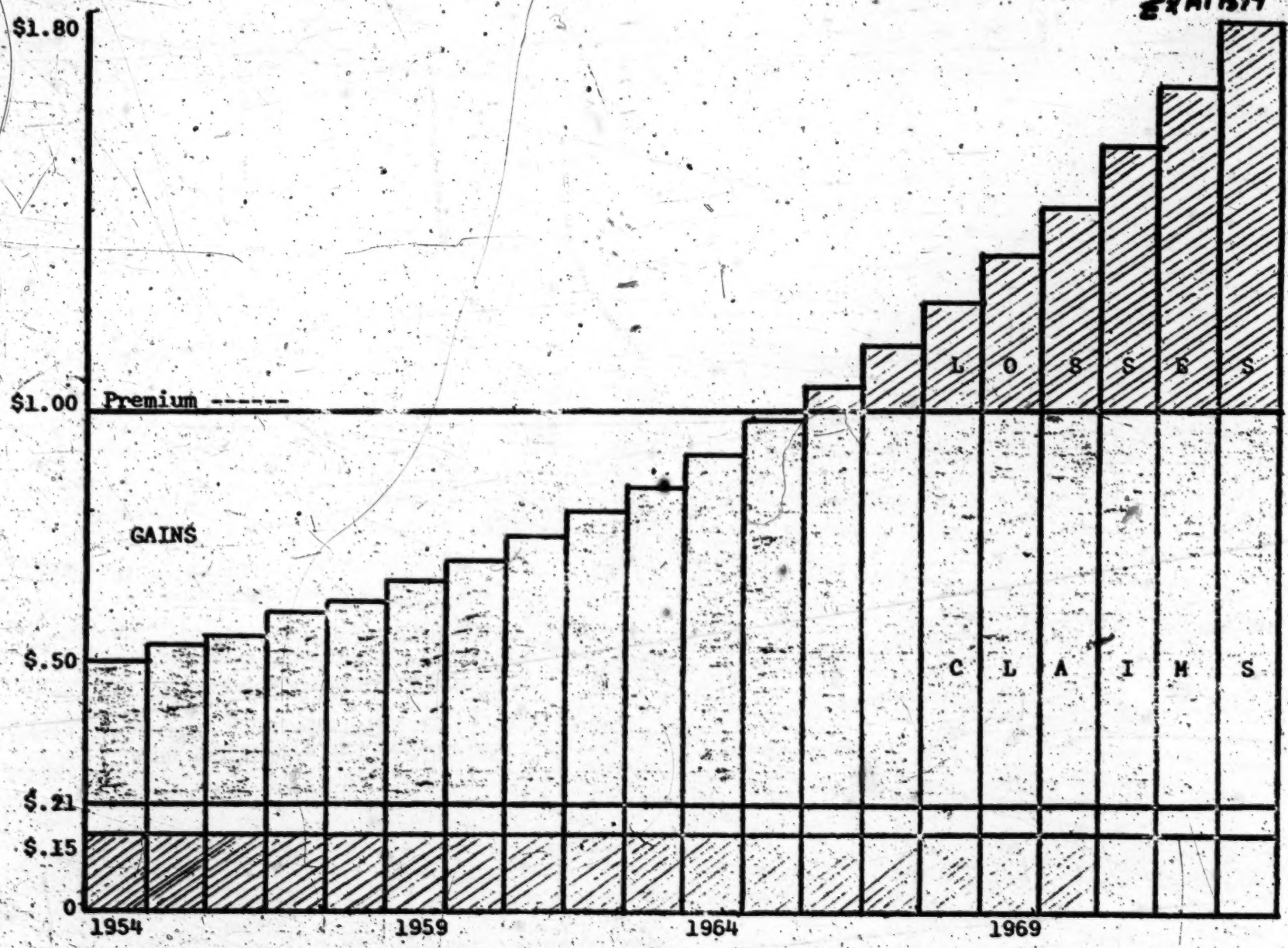
Year	Capital and Surplus	Maximum Retention	Percentage
1954	\$ 51,100.75	\$ 5,000	9.8
1955	161,860.47	5,000	3.2
1956	377,998.81	10,000	2.6
1957	597,877.15	10,000	1.7
1958	1,063,961.53	10,000	.9
1959	816,941.15	10,000	1.2

153

RECEIVED  
JAN 10 1964  
U.S. AIR FORCE  
HONOLULU, HAWAII  
AIR FORCE  
RECEIVED  
JAN 10 1964  
U.S. AIR FORCE  
HONOLULU, HAWAII  
AIR FORCE

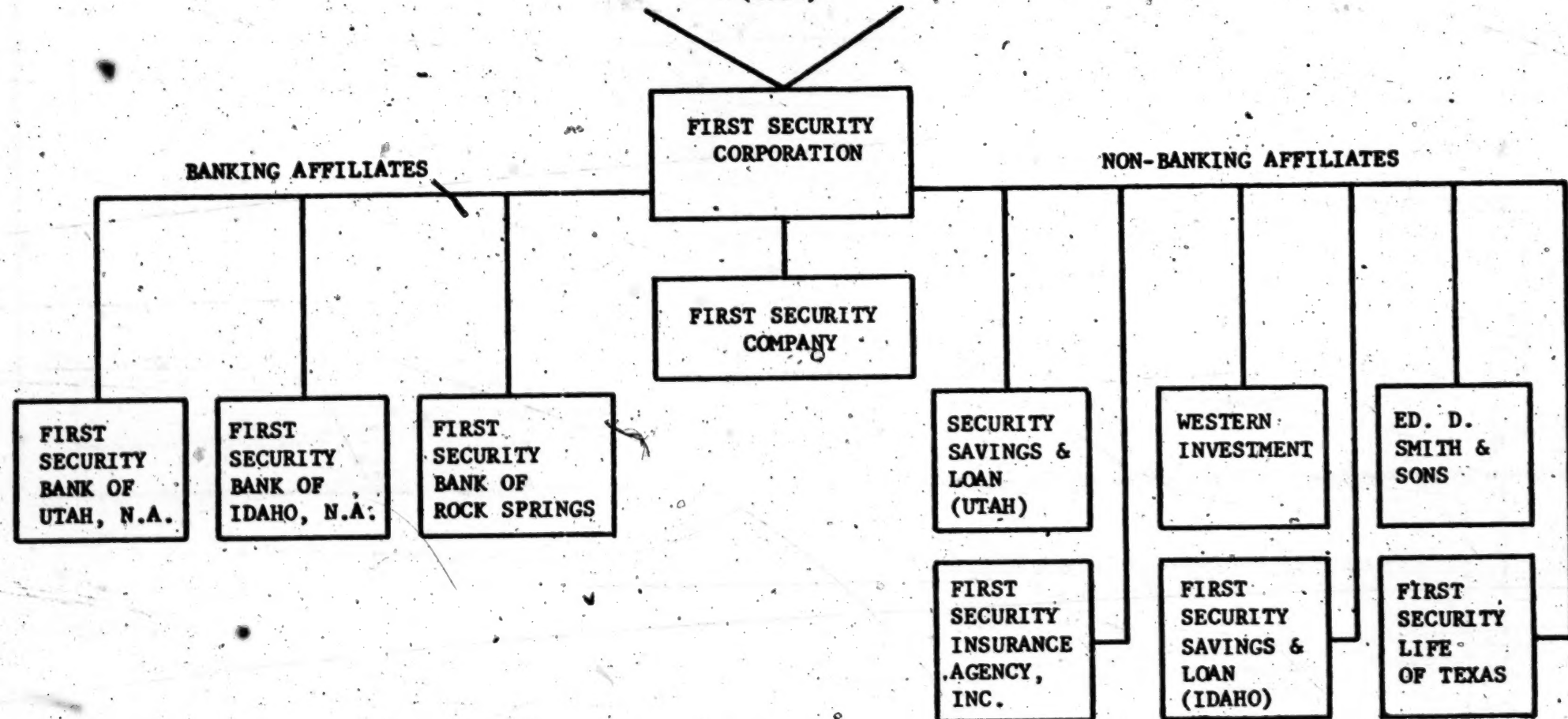


EXHIBIT 63

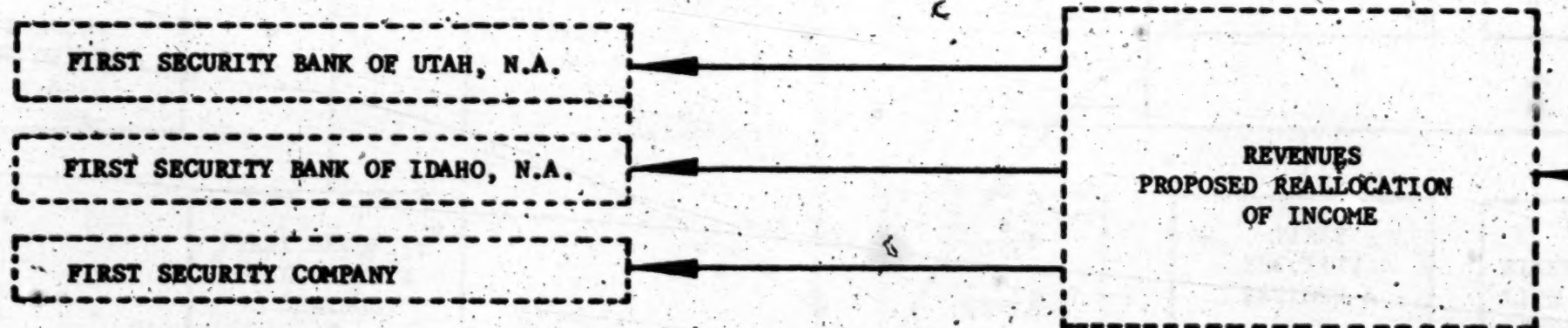
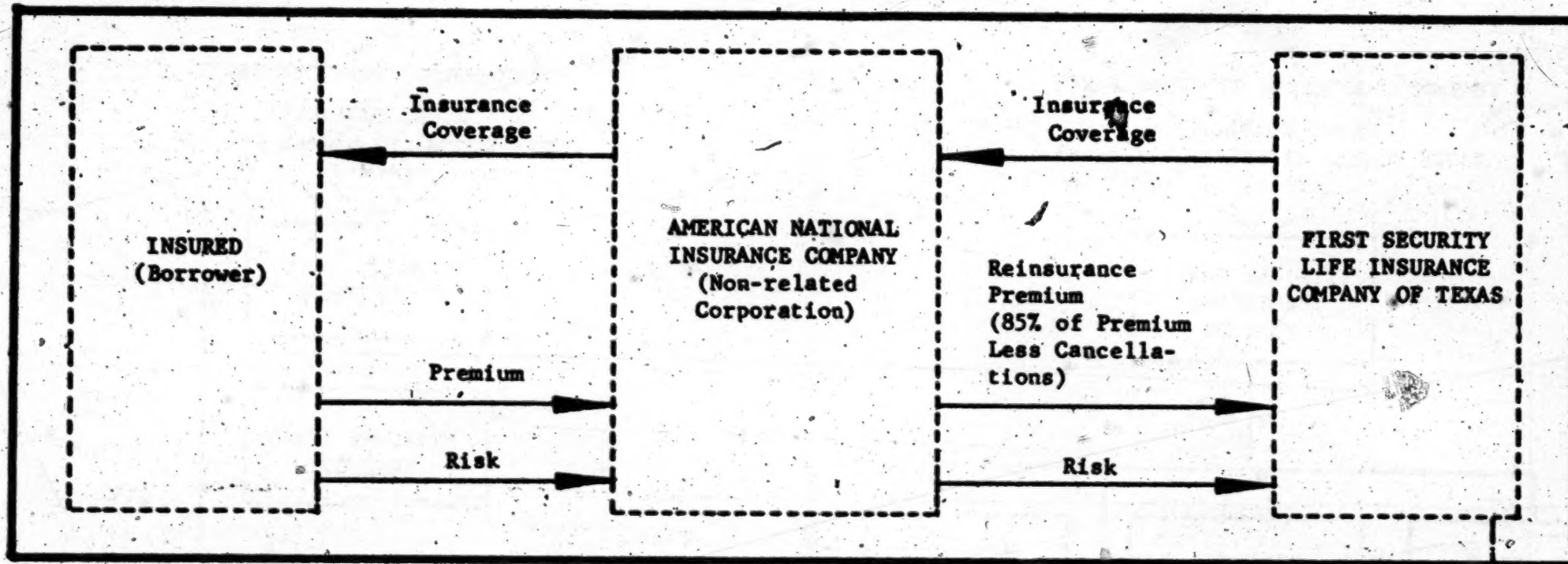


FIRST SECURITY LIFE INSURANCE COMPANY  
 INCREASING CLAIMS DUE TO  
 AGING  
 Age 45 Entry  
 (Based on 1958 CSO Table of Mortality)

PUBLICLY OWNED  
1,044,963 SHARES  
OF COMMON STOCK  
(1954)



BUSINESS TRANSACTION IN QUESTION





1

AFTER REORGANIZATION IN 1959  
TO COMPLY WITH THE BANK HOLDING COMPANY ACT OF 1956

FIRST SECURITY CORPORATION

PUBLICLY OWNED  
1,044,963 SHARES OF COMMON STOCK  
(1954)

FIRST SECURITY  
CORPORATION

FIRST SECURITY  
COMPANY

FIRST SECURITY  
BANK OF UTAH,  
N.A.

FIRST SECURITY  
BANK OF IDAHO  
N.A.

FIRST SECURITY  
BANK OF ROCK  
SPRINGS

FIRST SECURITY INVESTMENT COMPANY

PUBLICLY OWNED  
1,195,296 SHARES OF COMMON STOCK  
(1959).

FIRST SECURITY  
INVESTMENT  
COMPANY

SECURITY  
SAVINGS &  
LOAN  
(UTAH)

WESTERN  
INVESTMENT  
COMPANY

ED. D  
SMITH &  
SONS

FIRST  
SECURITY  
INSURANCE  
AGENCY, INC.

FIRST  
SECURITY  
SAVINGS &  
LOAN  
(IDAHO)

FIRST SECURITY  
LIFE INSURANCE  
COMPANY OF TEXAS





**-JOINT EXHIBIT CH-51**

**COMPARISON OF STOCK OWNERSHIP  
FIRST SECURITY CORPORATION AND  
FIRST SECURITY INVESTMENT COMPANY  
AS OF FEBRUARY 21, 1967**

On September 15, 1959, stock of various banking affiliates of First Security Corporation was transferred to a new corporation and the stock of that corporation was issued to shareholders of the First Security Corporation. Concurrently the name of the new (bank) holding company was changed to First Security Corporation, and the old corporation (with the non-banking affiliates) became the First Security Investment Company. At that time each corporation had 3,572 shareholders and 1,185,296 shares outstanding. From September 15, 1959, to December 31, 1959, 85,401 shares of First Security Corporation, representing 7.2% of its outstanding stock of 1,185,296, were transferred, and 105,174 shares of First Security Investment Company, representing 8.9% of its outstanding shares of 1,185,296 changed hands.

Since the reorganization and February 21, 1967, there have been changes in the identity of such shareholders and their stockholdings. The aggregate of such changes as obtained from a review of the stock records as of February 21, 1967, is as follows.

First Security Corporation, as of February 21, 1967, had issued and outstanding 2,591,692 shares, which are held by 5,488 shareholders, while First Security Investment Company had as of such date 1,105,685 shares outstanding and 4,086 shareholders.\*

2,656 shareholders of First Security Corporation holding 995,768 shares do not have equivalent (1 share of First Security Investment Company for each 2.12 shares of First Security Corporation) shareholdings in First Security Investment Company. This represents 38.4% of the total outstanding shares and 48.4% of the number of share-

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\* The stock of First Security Corporation was split two for one and there have been three 2% stock dividends during the period from December 31, 1959, to February 17, 1967, so that for every share of First Security Investment Company, there are 2.12 shares of First Security Corporation.

holders whose interests in the two corporations are not the same.

1,257 shareholders of First Security Investment Company are holding 328,744 shares which are not represented by equivalent holdings in the First Security Corporation. This represents 29.7% of the total voting shares outstanding and 30.8% of the total shareholders whose interests in the two corporations are not the same.

# TAX COURT OF THE UNITED STATES

T.C. Memo. 1967-256

[Caption Omitted]<sup>1</sup>

Filed December 27, 1967

## MEMORANDUM FINDINGS OF FACT AND OPINION

FAY, *Judge*: Respondent determined deficiencies in the petitioners' income taxes as follows:

Docket No.	Petitioner	Taxable year	Deficiency
1190-63	First Security Bank of Utah, N.A.	1954	\$ 68,250.00
		1955	28,775.81
		1956	54,526.56
		1957	77,862.91
		1958	159,371.46
1191-63	First Security Company	1959	109,166.60
		1956	95,997.48
		1957	126,400.83
		1958	262,124.10
		1959	179,550.34
1216-63	First Security Bank of Idaho, N.A.	1954	68,250.00
		1955	26,139.85
		1957	160,392.56
		1958	102,752.67

During the trial, respondent stated that he would not pursue one of the issues raised in the pleadings. We therefore conclude that he has abandoned it. The issues remaining for decision are:

(1) Whether respondent erred in allocating, pursuant to sections 61 and 482,<sup>2</sup> to petitioners First Security Bank of Utah, N.A., and First Security Bank of Idaho, N.A., a portion of the income which First Security Life Insurance Company of Texas received from January 1, 1955, to December 31, 1959, for reinsuring credit life, health, and acci-

<sup>1</sup> Proceedings of the following petitioners are consolidated herewith: First Security Company, Docket No. 1191-63, and First Security Bank of Idaho, N.A., Docket No. 1216-63.

<sup>2</sup> All statutory references are to the Internal Revenue Code of 1954, unless otherwise specified.



dent insurance,<sup>3</sup> or in the alternative, whether he erred in allocating, pursuant to said sections, to petitioner First Security Company a portion of said income which First Security Life Insurance Company of Texas received from January 1, 1956, to December 31, 1959; and

(2) whether respondent properly put section 482 in issue and, if so, whether he should have the burden of proof.

#### FINDINGS OF FACT

Some of the facts have been stipulated, and the stipulation of facts, together with the exhibits attached thereto, is incorporated herein by this reference.

Petitioner First Security Bank of Utah, N.A. (hereinafter referred to as Utah Bank), is a national bank incorporated in 1882. It filed its Federal income tax returns for the taxable years involved herein on a calendar year basis with the district director of internal revenue, Salt Lake City, Utah. Its principal place of business was Salt Lake City, Utah, when it filed its petition in this case.

Petitioner First Security Bank of Idaho, N.A. (hereinafter referred to as Idaho Bank), is a national bank, incorporated as such in 1941 after operating since 1865 as a state bank. It filed its Federal income tax returns for the taxable years involved herein on a calendar year basis with the district director of internal revenue, Boise, Idaho. Its principal place of business was Boise, Idaho, when it filed its petition in this case.

Petitioner First Security Company (hereinafter referred to as Management Company) is a corporation organized under the laws of Utah in 1929. It filed its Federal income tax returns for the taxable years involved herein on a calendar year basis with the district director of internal revenue, Salt Lake City, Utah. Its principal place of business was Salt Lake City, Utah, when it filed its petition in this case.

Petitioners are wholly-owned subsidiaries of the First Security Corporation (hereinafter referred to as Holding

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<sup>3</sup> The statutory notice received by petitioner First Security Bank of Idaho, N.A., contained adjustments to certain net operating loss carrybacks. Because of these adjustments, this Court has jurisdiction under section 6214(b) to determine the correctness of respondent's allocations to this petitioner for the years 1956 and 1959.

Company). It is the oldest bank holding company in existence. It is under the supervision and control of, and is regularly examined by, the Federal Reserve System. It is qualified under and subject to the Bank Holding Company Act, 12 U.S.C. sections 1841 *et seq.* From 1954 through September 15, 1959, Holding Company had approximately 1,044,963 shares of common voting stock outstanding and from 2,000 to 3,000 shareholders residing in various states and foreign countries.

Holding Company has had a policy of business expansion and acquisition throughout its existence. The banking offices of its subsidiaries extend from the Canadian border to the Arizona border. Moreover, it has entered into diversified enterprises other than banking.

From 1954 to September 15, 1959, Holding Company had the following wholly-owned subsidiaries, in addition to petitioners:

(a) The First Security Life Insurance Company of Texas (hereinafter referred to as Security Life), a corporation organized and licensed as an insurance company pursuant to the laws of Texas.

(b) Ed. D. Smith and Sons (hereinafter referred to as Smith), a Utah corporation. It had approximately twenty employees and sold life and casualty insurance. It had a yearly premium volume of approximately \$800,000.

(c) First Security Insurance Agency, Inc. (hereinafter referred to as Agency), an Idaho corporation. It sold insurance and had a yearly premium volume of about \$175,000.

(d) Western Investment Corporation, an Idaho corporation holding various assets.

(e) First Security State Bank, a Utah State bank.

(f) First Security Bank, a Wyoming State bank.

(g) Security Savings and Loan Association, a Utah State savings and loan association; and

(h) First Security Savings and Loan Association, an Idaho State savings and loan association.

On September 15, 1959, Holding Company underwent a reorganization pursuant to the Bank Holding Company Act, *supra*. The banking subsidiaries, including the three petitioners herein, were placed in a newly-organized bank holding company. The shareholders of Holding Company received the stock of the new bank holding company. The

nonbanking subsidiaries, including Security Life, remained in the old holding company.

Utah Bank and Idaho Bank have numerous banking offices. Both are subject to supervision, inspection, and control by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency and are regularly examined by them. The articles of incorporation of the banks limit them to the business of banking under the laws of the United States. Under the national banking laws, the members of the boards of directors of the banks are responsible for the proper operation of the banks. During the years in issue, Utah Bank had 141,000 to 192,000 depositors and \$217,000,000 to \$292,000,000 in deposits. During the same years, Idaho Bank had 113,000 to 131,000 depositors and \$183,000,000 to \$205,000,000 in deposits.

Management Company provides accounting and other management services to the other subsidiaries of Holding Company. Management Company is subject to control, supervision, and inspection by the Board of Governors of the Federal Reserve System and is regularly examined by it.

In 1948 Utah Bank and Idaho Bank began making available credit life, health, and accident insurance (hereinafter referred to as credit insurance)<sup>4</sup> to their customers. They did this for several reasons, including (1) to offer a service increasingly supplied by competing financial institutions, (2) to obtain the benefits of the additional collateral which credit insurance provides by repaying loans upon the death, injury, or illness of the borrower, and (3) to provide an additional source of income—part of the premiums from the insurance—to Holding Company or its subsidiaries.

From 1948 through 1952, Credit Life Insurance Company of Springfield, Ohio, wrote the credit insurance which Utah Bank and Idaho Bank had available for their customers. Credit Life Insurance Company and Smith entered into

<sup>4</sup> Although the new holding company received the name of the old one—First Security Corporation—while the old one changed its name to First Security Investment Company, the term “Holding Company” will continue to refer to the pre-reorganization holding company.

<sup>5</sup> For a description of the credit insurance industry, see *Local Finance Corporation*, 48 T.C. 773 (1967), at 776 et seq.

agency agreements designating Smith as Credit Life's agent in writing the the insurance. Pursuant to the agreements, Credit Life paid commissions to Smith as follows:

Period	Amount of payment to Smith per agency agreement.	Characterization of payment in agency agreement
9-24-48 through 6-1-50.	40 to 50 percent of net premiums collected, based on volume.	Commissions.
6-1-50 through 12-31-52.	55 percent of premiums.	45 percent commission, 10 percent expense reimbursement.

From January 1, 1953, through April 1, 1954, American Bankers Life Assurance Company of Florida wrote the credit insurance which Utah Bank and Idaho Bank had available for their customers. American Bankers Life Assurance Company and Smith entered into an agency agreement designating Smith as American Bankers' agent in writing the insurance. Pursuant to the agreement, American Bankers paid commissions to Smith of 55 percent of the net premiums collected on life insurance and 50 percent of the net premiums collected on health and accident insurance.

Late in 1953, American National Insurance Company of Galveston, Texas (hereinafter referred to as National),<sup>\*</sup> approached Holding Company with a plan whereby National would write the credit insurance which Utah Bank and Idaho Bank made available to their customers. The plan called for Holding Company to create a life insurance subsidiary. The subsidiary's business would be to reinsure the risks of the credit insurance policies written by National for the customers of the two Banks. Profits from the business could be retained in the subsidiary for investment. In its initial years, the subsidiary would utilize National's established and experienced operating services—actuarial, accounting, etc.—on a fee basis. If the plan proved successful, the new insurance subsidiary could grow into a full-line, direct-writing insurance company.

Holding Company was one of many financial institutions which National approached with such a plan. During 1953 National concluded that lending institutions would soon

<sup>\*</sup> National is a leading nationwide insurance company. It is independent of and unrelated to Holding Company and its subsidiaries.



begin to form their own life insurance companies to write the credit insurance which they made available to their customers. They based their conclusion upon the facts that writing credit insurance was proving to be a very profitable business and that there were considerable tax savings on premium income.<sup>7</sup> This potential move by lending institutions would ultimately deprive National and other independent insurance companies of their credit insurance business. To salvage what it could from the situation, National decided to encourage lending institutions to develop their own life insurance companies by utilizing the operating services which National had developed for writing credit insurance. By charging a fee for the services, National would recoup something from its investment in the credit insurance business.

Holding Company decided to adopt National's plan. It did so for numerous reasons, including its policy of business expansion. To implement the decision, Holding Company incorporated Security Life in June 1954. Security Life was incorporated under the laws of Texas and approved by the Texas State Board of Insurance Commissioners. It had an initial capital of \$25,000<sup>8</sup> and an initial paid-in surplus of \$12,500.<sup>9</sup>

National began writing credit insurance for the customers of Utah Bank and Idaho Bank in April 1954. The insurance was reinsured with Security Life under contracts called reinsurance treaties. Under the treaties National received approximately 15 percent of the premium dollar for its managerial services and Security Life received the balance of the premium dollar for its assumption of 100 percent of the risk under the insurance policies.<sup>10</sup>

From April 1954 through 1959, National maintained Security Life's books and records and computed its re-

<sup>7</sup> The Life Insurance Company Income Tax Act of 1959 in large part eliminated the tax savings. See generally Mertens, sec. 44A.01 *et seq.*

<sup>8</sup> Security Life's capital was increased to \$100,000 in 1956 through a \$75,000 stock dividend.

<sup>9</sup> This was an unusually low capitalization with which to begin an insurance company. In 1954 Texas had low minimum capitalization requirements for incorporating insurance companies.

<sup>10</sup> The maximum on one life under the policies which Security Life reinsured was \$5,000.

quired reserves. By purchasing the services of National Holding Company effected considerable savings over what would have been the case had it attempted to launch a full-line, direct-writing company from the outset. It is a common practice to begin an insurance company by reinsuring risks and, if successful, grow into a full-line, direct-writing company.<sup>11</sup> There is no basic actuarial or business difference between an insurance company which reinsures and a direct-writing company.

Utah Bank and Idaho Bank had a routine procedure for making credit insurance available to customers. A loan officer explained the availability and function of credit insurance to a customer. If the customer desired the insurance, the loan officer gave him application forms. The customer then filled in the application. After examining the application, Bank personnel filled in a certificate of insurance and either collected the premium from the customer or added it to his loan. As the final step, Bank personnel forwarded the completed forms to Management Company for further handling.

Utah Bank and Idaho Bank did not require customers to purchase credit insurance. During the years in issue, less than one-half of the Banks' installment loan customers elected to take insurance and less than 13 percent of the Banks' real estate loan customers elected to take insurance.

The cost to Utah Bank and Idaho Bank of processing the insurance was negligible. For the five years in issue, the total cost to Utah Bank was \$8,929.30 and the total cost to Idaho Bank was \$9,826.43.<sup>12</sup>

Management Company's role in processing the credit insurance was in the nature of bookkeeping. It had no contact with the public with respect to writing credit insurance. It received the forms, duplicate certificates, and premiums from Utah Bank and Idaho Bank. It then made records of insurance purchased and forwarded premiums to National. It also did the paper work when claims had to be filed under the policies.

The cost to Management Company of processing the

<sup>11</sup> Security Life never developed into a full-line, direct-writing company.

<sup>12</sup> These figures are derived from an extensive time-cost study prepared by an employee of Management Company.

insurance was negligible. For the five years in issue, the total cost was \$10,150.34.<sup>12</sup>

Idaho Bank, Utah Bank, and Management Company were not parties to the legal relationships and obligations of the insurance policies. National wrote the insurance and the Banks' customers were its policyholders. Under the terms of the policies, National was responsible for payment of claims. Under the reinsurance treaties, Security Life was obligated to reimburse National for claims it paid.

Other than group policies, there were no contracts, agency agreements, or other legal connections between National and Idaho Bank, Utah Bank, or the employees of both. There were no contracts, agency agreements, or other legal connections between National and Management Company or its employees.

From 1948 through 1959, the credit insurance which Idaho Bank and Utah Bank made available to their customers was priced at the uniform rate of \$1 per \$100 coverage per year on a decreasing term basis. This was the rate commonly charged in the industry. It was accepted by the insurance commissioners of the states involved herein—Utah, Idaho, and Texas.

During the years in issue, Security Life paid state and Federal taxes, used its own stationery, made deposits and withdrawals from bank accounts in its own name, and invested in its own name. Its sole source of business income was reinsurance premiums. Its business expenses were primarily bank charges, taxes, and claims settlement expenses.

Security Life's credit insurance business was very profitable. Its yearly operations for the period 1955 through 1959 are reflected in the following table:

Year	Net premium <sup>1</sup>	National's fee	Reinsurance premium received by Security Life	Claims and claims expenses	Net profit to Security Life
1955	\$145,927.55	\$24,765.65	\$121,161.90	\$45,340.38	\$75,821.52
1956	277,437.45	43,695.72	233,741.73	97,609.66	136,132.07
1957	367,612.62	55,590.64	312,021.98	114,014.49	198,007.49
1958 <sup>2</sup>	647,874.90	62,954.22	584,920.68	118,874.46	466,046.22
1959	477,389.43	71,608.43	405,781.00	149,948.92	255,832.08
Total	\$1,916,241.95	\$258,614.66	\$1,657,627.29	\$525,787.91	\$1,131,839.38
Less closing Life Reserve, 12-31-59					110,806.00
Less general expense for period 1-1-55 through 12-31-55					16,339.00
Total profit					\$1,004,694.38

<sup>1</sup> Gross premium less cancellations and adjustments.

<sup>2</sup> Includes 1958 reserve adjustment.

<sup>12</sup> This figure is derived from the time-cost study described in footnote 12, *supra*.

Security Life's operations for the years in issue are summarized in the following table in terms of percentages of total net premiums received.

Item:	Percent of total net pre- miums received
Fee paid to National	13.5
Claims paid	27.4
Life reserve on 12/31/59 and general expenses	6.6
Balance	52.5
Total	100.0

Security Life's balance sheets for the period January 1, 1955, through December 31, 1959, are summarized in the following table:

	1955	1956	1957	1958	1959
Assets	\$161,370.52	\$390,286.87	\$648,586.43	\$1,204,424.45	\$1,050,220.71
Liabilities (including reserves)	18,076.98	22,295.00	30,277.60	271,479.08	197,687.00
Capital	25,000.00	100,000.00	100,000.00	100,000.00	100,000.00
Surplus:					
Paid-in	12,500.00	12,500.00	12,500.00	12,500.00	12,500.00
Unassigned		35,099.41			
Earned	110,793.54	220,392.46	505,808.83	820,445.39	740,033.71
	\$161,370.52	\$390,286.87	\$648,586.43	\$1,204,424.45	\$1,050,220.71

<sup>1</sup> Security Life paid a dividend of \$389,821.61 to Holding Company during 1959.

Although Security Life's business proved to be successful, there was no way to judge at the outset whether it would succeed. In relation to its capital structure, Security Life reinsured a large amount of risk. The following table shows the number of policies reinsured, the amount of risk it assumed, and the number of extra maximum claims which would have eliminated its surplus at the end of a year:

Year	Number of policies	Amount of risk at end of year	Number of extra maximum claims which would have eliminated surplus
1954	12,500	\$ 6,483,000	3
1955	27,594	13,360,000	9
1956	34,388	21,105,000	28
1957	29,591	25,570,000	28
1958	32,155	36,761,000	50
1959	36,416	41,350,000	97



Furthermore, there were several aspects of Security Life's business which could have invited high mortality rates. Customers of the two Banks could obtain credit insurance without a health examination and there was no waiting period before the insurance went into effect. In addition, Security Life was a relatively small insurance company and its policyholders lived in a relatively limited geographical area.

Since Utah Bank and Idaho Bank began making available credit insurance to their customers in 1948, the officers of Holding Company and of the two Banks have held the belief that it would be contrary to Federal banking law for the two Banks to receive income resulting from their customers' purchase of credit insurance. They based the belief on the advice of legal counsel. Pursuant to the belief, the two Banks have never received or attempted to receive commissions or reinsurance premiums resulting from their customers' purchase of credit insurance.

Petitioners Idaho Bank and Utah Bank reported no income from sales of credit insurance on their Federal income tax returns for the years 1955 through 1959. Petitioner Management Company reported no income from sales of credit insurance on its Federal income tax returns for the years 1956 through 1959.

In his statutory notices of deficiency, respondent allocated to petitioners Utah Bank and Idaho Bank the reinsurance premiums received by Security Life from 1955 through 1959. He also, alternatively, allocated to petitioner Management Company the reinsurance premiums received by Security Life from 1956 through 1959.<sup>14</sup> The pertinent explanatory material in each notice of deficiency is as follows:

It is determined that the insurance premium[s] and/or commission income reported as income by the First Security Life Insurance Company of Texas, a corporation, the stock of which is owned by The First

<sup>14</sup> During the trial and on brief, respondent only urged the allocation of 40 percent of the net premiums which Security Life received from reinsuring credit insurance. He did not allocate any income which Security Life received for reinsuring risks on mortgage, twin-dollar, and borrow-by-check insurance, three types of insurance which Security Life reinsured in addition to what we refer to herein as credit insurance.

Security Corporation, the same corporation which owns your stock, should have been reported by you. Therefore, your taxable income is increased as indicated for each of the taxable years 1955 [1956] through 1959.

In a different case than the one at bar, respondent has asserted a deficiency against Security Life for the years 1955 through 1959. More than three years before the trial of the present case, Security Life filed a sworn protest with the district director of internal revenue, Salt Lake City, Utah, contesting the asserted deficiency. Counsel for petitioners herein prepared Security Life's protest. To explain the difference between Security Life's case and the case at bar, the protest contains the following language:

The issues involved are not at all related; each turns on its own set of facts and its own section of the Internal Revenue Code. The issue involved in the bank cases is whether the banks were the true earners of the income, and hence taxable under Section 482. The issue in this case is whether the reserves were established and maintained on an actuarial basis as required by Section 801(a).

In the case at bar, respondent never filed any document prior to the pretrial conference formally notifying petitioners that he intended to rely on section 482. Two days prior to the trial herein, respondent filed a motion for a pretrial conference pursuant to Rule 28, Rules of Practice of the Tax Court. In the motion, respondent stated that he would rely on section 482 as well as section 61.

#### OPINION

The first issue is whether respondent has properly put section 482 in issue.

Petitioners argue that because respondent did not specifically mention section 482 in his notices of deficiency, and because he did not otherwise specifically and formally notify petitioners prior to the pretrial conference that he would rely on section 482, he is barred from relying on that section. Alternatively, petitioners argue that if we permit respondent to rely on section 482, he should bear the burden of proof because the determination with respect

to the section 482 issue in the statutory notices does not contain sufficient legal and factual grounds.

We do not agree with either argument. Petitioner's counsel knew three years in advance of the trial that respondent would rely on section 482. Moreover, petitioners do not allege surprise or suggest that they were prejudiced in any way by respondent's alleged omissions. It is clear from the record that petitioners' counsel were well prepared with an extensive and thorough case on the section 482 issue. In view of these circumstances, the cases which petitioners cite on this point are distinguishable. We hold that respondent has properly put section 482 in issue and that petitioners have the burden of proof.

The second issue is whether respondent erred in allocating, pursuant to sections 61 and 482, either to Utah Bank and Idaho Bank or to Management Company 40 percent of the net premiums which Security Life received during the years in issue for reinsuring credit insurance.

In all essential respects, the facts of the case at bar are the same as those in *Local Finance Corporation*, 48 T.C. 773 (1967). Because of our decision in that case, most of petitioners' arguments on this issue are untenable. Petitioners do, however, make two arguments concerning the actuarial soundness of respondent's allocations which are not foreclosed by our earlier decision.<sup>15</sup>

Petitioners' main actuarial argument is based upon the testimony of their expert actuary. The crux of the testimony is the opinion contained in the following exchange:

Q. What is your opinion?

A. The size and nature of the risk assumed by this company [Security Life] in relationship to its capital structure required it to retain every dollar that it could possibly do so.

Q. To stay on an actuarially sound basis?

A. Yes.

Petitioners' actuary based his opinion upon the amount of risk which Security Life reinsured and upon factors in its insurance operation which might have invited high mortality rates.

Petitioners claim that their actuarial evidence demonstrates that Security Life would have been actuarially

<sup>15</sup> See *Local Finance Corporation*, *supra*, at 791.

unsound if it had paid an insurance commission to the Banks equal to what respondent now allocates to them. It follows, petitioners argue, that respondent's allocation pursuant to sections 61 and 482 is unreasonable.

We do not agree. The central fact upon which petitioners' actuary based his testimony was Security Life's initial capital structure of \$37,500. In the above-quoted passage he said that Security Life assumed great risk "in relationship to its capital structure." Respondent's actuary pointed out that Security Life's initial capitalization was unusually low for an insurance company. Petitioners' actuary corroborated this with the following testimony:

Now, within the life insurance industry there is a very much used rule of thumb for new life insurance companies that is to establish it with capital and surplus of approximately 100 times its maximum risk on one life.

This is arbitrary and a rule of thumb, but it is also true that throughout the industry the amount that companies will retain on one life is closely in that neighborhood.

The maximum risk on one life under the policies reinsured by Security Life was \$5,000. Using the formula suggested by petitioners' actuary, Security Life's initial capitalization should have been \$500,000, not \$37,500. If its initial capitalization had been \$500,000 rather than \$37,500, petitioners' actuarial evidence would be meaningless. The validity of the evidence, in other words, hinges upon the fact that Security Life began business as an undercapitalized insurance company. This evidence does not persuade us that respondent's allocation pursuant to sections 61 and 482 is unreasonable.

Petitioners make another actuarial argument based upon the fact that respondent, during trial and on brief, did not allocate to them Security Life's income from reinsuring risks on lines of insurance other than what we herein refer to as credit insurance. Petitioners contend that respondent ignored these lines because Security Life had a much higher claims experience with them than with credit insurance. Petitioners argue that this omission by respondent is a concession that a 40 percent allocation on the other lines of insurance would be unreasonable. They conclude that



what is unreasonable for the other lines of insurance is also unreasonable for credit insurance.

We do not agree. Petitioners did not attempt to prove any business or actuarial similarities between Security Life's reinsurance of credit insurance and its reinsurance of other lines. It follows that we cannot draw inferences between the two lines. We do not decide what meaning, if any, attaches to the fact that respondent did not allocate Security Life's income from reinsuring the other lines of insurance.

Neither of petitioners' actuarial arguments persuades us that respondent's allocation pursuant to sections 61 and 482 is unreasonable. The arguments do not, therefore, distinguish the present case from *Local Finance Corporation, supra*. It follows that we must uphold as reasonable respondent's allocation of part of Security Life's income.

One problem remains—to which taxpayer should we allocate the income in question. Respondent, in his notices of deficiency, allocates the income either to Utah Bank and Idaho Bank or to Management Company.

Petitioners argue that the only taxpayers to which we can properly allocate the income are Smith and Agency, neither of which is a party herein. Their theory is based upon the facts that from 1948 through 1954 insurance commissions for the sale of credit insurance in the two Banks were payable to Smith and that during the years here in issue Smith and Agency held licenses to sell insurance. Because insurance commissions have never been payable to petitioners, and because none of the petitioners has ever held a license to sell insurance, they argue that it is logical to allocate the income to Smith and Agency, rather than to them.

We do not agree. Petitioners performed services with regard to the sale of credit insurance during the years in issue. Smith and Agency did not. Therefore, it is not proper to allocate the income to Smith and Agency. See concurring opinion in *Local Finance Corporation, supra*, at 797.

Among the petitioners, we allocate the income to Utah Bank and Idaho Bank. Our decision in *Local Finance Corporation* dictates this result.

*Decisions will be entered under Rule 50.*

## TAX COURT OF THE UNITED STATES

Docket No. 1190-63

[Caption Omitted]

## DECISION

(Entered May 7, 1969)

Pursuant to the opinion of the Court filed December 27, 1967, and incorporating herein the facts recited in the respondent's computation as the findings of the court, it is

Ordered and Decided: That there are deficiencies in income taxes due from the petitioner as follows:

Year	Deficiency
1954	\$ None
1955	13,810.59
1956	24,900.55
1957	35,777.24
1958	64,670.35
1959	48,705.19

/s/ Wm. M. Fay

(Seal)

Judge

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

Alonzo W. Watson, Jr.  
*Counsel for Petitioner.*

Richard M. Hahn,  
*Acting Chief Counsel,  
Internal Revenue Service.*

## TAX COURT OF THE UNITED STATES

Docket No. 1191-63

*[Caption Omitted]*

## DECISION

(Entered May 7, 1969)

Pursuant to the opinion of the Court filed December 27, 1967, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

Ordered and Decided: That there are no deficiencies in income taxes due from, or over-payments due to, the petitioner for the taxable years 1956, 1957, 1958 and 1959.

Wm. M. Fay  
Judge

(Seal)

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

Alonzo W. Watson, Jr.  
*Counsel for Petitioner.*

Richard M. Hahn,  
*Acting Chief Counsel,  
Internal Revenue Service.*

## TAX COURT OF THE UNITED STATES

Docket No. 1216-63

*[Caption Omitted]*

## DECISION

(Entered May 7, 1969)

Pursuant to the opinion of the Court filed December 27, 1967, and incorporating herein the facts recited in the re-

spondent's computation as the findings of the Court, it is Ordered and Decided: That there is no deficiency in income tax due from, or overpayment due to, the petitioner for the taxable year 1954; and

That there are deficiencies in income taxes due from the petitioner for the taxable years 1955, 1957 and 1958 in the amounts of \$16,542.34, \$124,084.44 and \$70,087.63, respectively.

Wm. M. Fay  
Judge

(Seal)

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

Alonzo W. Watson, Jr.  
*Counsel for Petitioner.*

Richard M. Hahn,  
*Acting Chief Counsel,  
Internal Revenue Service.*

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TAX COURT OF THE UNITED STATES

Docket No. 1190-63

[Caption Omitted]

Notice Of Appeal

Notice is hereby given that First Security Bank of Utah, N.A., hereby appeals to the United States Court of Appeals for the 10th Circuit from the decision of the Court entered in the above captioned proceeding on the 7th day of May, 1969, relating to the reallocation of income from the First Security Life Insurance Company of Texas to the First Security Bank of Utah, N.A., the burden of proof and reliance on Section 482 of the Internal Revenue Code, and from the order of the Court denying petitioner's motion



to alter and amend findings and for a reconsideration,  
which order was entered March 19, 1968.

Dated this 23rd day of July, 1969.

Ray, Quinney & Nebeker  
By Alonzo W. Watson, Jr.  
*Attorneys for Petitioner-Appellant*  
*First Security Bank of Utah, N.A.*

Stamp  
Tax Court Mail Room  
1969 Jul 28 AM 8 34  
Filed July 28, 1969.

TAX COURT OF THE UNITED STATES, WASHINGTON, D. C.

Docket No. 1191-63

[Caption Omitted]

Notice Of Appeal

Notice is hereby given that the Commissioner of Internal Revenue appeals to the United States Court of Appeals for the Tenth Circuit from the decision of this Court entered in the above-captioned proceedings on the 7th day of May, 1969, wherein the Court ordered and decided that there were no deficiencies in income tax due from petitioner for its taxable years 1956, 1957, 1958 and 1959.

On the date that taxpayer filed its petition with the Tax Court of the United States, its principal place of business was located in Salt Lake City, Utah thereby establishing venue in the United States Court of Appeals for the Tenth Circuit.

Johnnie M. Walters  
*Assistant Attorney General*  
*Department of Justice*  
K. Martin Worthy, *Chief Counsel*  
*Internal Revenue Service*  
*Counsel for Appellant on Review*

Of Counsel:  
Bobby D. Burns  
*Attorney*  
*Internal Revenue Service*  
Filed August 4, 1969.

## TAX COURT OF THE UNITED STATES

Docket No. 1216-63

*[Caption Omitted]*

## Notice Of Appeal

Notice is hereby given that First Security Bank of Idaho, N.A., hereby appeals to the United States Court of Appeals for the 10th Circuit from the decision of the Court entered in the above captioned proceeding on the 7th day of May, 1969, relating to the reallocation of income from the First Security Life Insurance Company of Texas to the First Security Bank of Idaho, N.A., the burden of proof and reliance on Section 482 of the Internal Revenue Code, and from the order of the Court denying petitioner's motion to alter and amend findings and for a reconsideration, which order was entered March 19, 1968.

Dated this 29th day of July, 1969.

Stamp  
Tax Court Mail Room  
1969 Jul 31 AM 8 36

Ray, Quinney & Nebeker  
By Alonzo W. Watson, Jr.  
*Attorneys for Petitioner-Appellant*  
*First Security Bank of Idaho, N.A.*

Filed July 31, 1969.

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United States Court of Appeals, Tenth Circuit

January Term, 1971

[Captions Omitted]

APPEALS FROM DECISIONS OF THE TAX COURT OF THE  
UNITED STATES

Before BREITENSTEIN and SETH, Circuit Judges, and  
TEMPLAR, District Judge.

BREITENSTEIN, Circuit Judge.

These consolidated appeals from the Tax Court relate to the allocation of income among taxpayers. No. 611-69 is an appeal by First Security Bank of Utah, N.A., (Utah Bank) from the decision that for the years 1955 to 1959 inclusive there is a deficiency in income taxes due from the taxpayer in the amount of \$187,863.92. No. 612-69 is an appeal by First Security Bank of Idaho, N.A., (Idaho Bank) from the holding that for the tax years 1955, 1957, and 1958 there is a deficiency of \$210,714.41. No. 613-69 is a protective appeal by the Commissioner of Internal Revenue from the decision that there are no deficiencies in the income taxes due from First Security Company (Management Company) for the years 1956 to 1959 inclusive. The Tax Court held that approximately 40% of credit insurance net premiums paid by borrowers from the two banks, and reported by another corporation, were allocable to income of the banks. Jurisdiction is conferred by 26 U.S.C. § 7482 (a). Venue for the appeal of the Idaho Bank is in this court pursuant to a stipulation made under § 7482(b)(2). The findings of fact and opinion of the Tax Court are not officially reported but are found at 26 T.C.M. 1320.

The taxpayers are national banks. They and a Wyoming bank, Management Company, and certain nonbanking affiliates were until 1959 wholly owned subsidiaries of First Security Corporation, a bank holding company which is publicly owned. During the years in issue Utah Bank had 141,000 to 192,000 depositors and \$217,000,000 to \$292,000,000 in deposits and Idaho Bank had 113,000 to 131,000 depositors and \$183,000,000 to \$205,000,000 in deposits. Management Company provided accounting and other managerial services to subsidiaries of Holding Company.

Since 1948 the banks have made available to their bor-

rowers credit life, health, and accident insurance which pays off the debt in case the borrower dies or is incapacitated during the term of his loan. The Tax Court found that they did this "for several reasons, including (1) to offer a service increasingly supplied by competing financial institutions, (2) to obtain the benefits of the additional collateral which credit insurance provides by repaying loans upon the death, injury, or illness of the borrower, and (3) to provide an additional source of income—part of the premiums for the insurance—to Holding Company or its subsidiaries." The premium charge for the credit insurance was at the uniform rate of \$1.00 per \$100.00 of coverage per year on a decreasing term basis. This was the rate commonly charged in the industry and was accepted by the insurance commissioners of the states involved—Utah, Idaho, and Texas. The banks did not require their borrowers to purchase credit insurance. During the taxable years less than 50% of their installment loan customers and less than 13% of their real estate loan customers elected to take insurance.

The banks had a routine procedure for making credit insurance available to customers. A loan officer explained the function and availability of the insurance. If the customer desired the insurance, the loan officer gave him the application forms for completion. Bank personnel examined the application, made out a certificate of insurance, and either collected the premium from the customer or added it to his loan. There is no showing that any of the bank personnel were licensed insurance agents. As the final step, bank employees forwarded the completed forms and premiums to Management Company for further handling. Management Company's role in processing the credit insurance was in the nature of bookkeeping. It had no contact with the public in respect to the writing of credit insurance. It received the forms, duplicate certificates, and premiums from the banks, made records of the insurance purchased, and forwarded the premiums to the insurance carrier. It also did the paper work when claims were filed under the policies. /

The following items show pertinent facts with regard to the credit insurance which concerns us.

1. The number of policies written and the amount of risk at the end of each year, 1954 to 1959, inclusive, varied from



a low of 12,500 and \$6,483,000 respectively in 1954 to a high of 36,416 and \$41,350,000 respectively in 1959.

2. The net premiums for the years 1955 to 1959 inclusive totalled \$1,916,241.95.

3. The claims and claim expenses for the years 1955 to 1959 inclusive totalled \$525,787.91.

4. For the years in issue the total cost to the Utah Bank for processing the insurance was \$8,929.30, to the Idaho Bank \$9,826.43, and to Management Company \$10,150.34. The Tax Court described these costs as "negligible."

From 1948 to April 1, 1954, the credit insurance coverage on the banks' borrowers was carried first by Credit Life Insurance Company of Springfield, Ohio, and later by American Bankers Life Assurance Company of Florida, both of which were independent of Holding Company and its subsidiaries. Commissions varying from 40% to 55% of net premiums were paid to Ed. D. Smith & Sons which was an insurance agency and a wholly owned subsidiary of Holding Company.

American National Insurance Company of Galveston, Texas, an independent company, wrote a large volume of credit insurance. Foreseeing a change in the credit insurance business, National, late in 1953, approached Holding Company and other financial institutions with a plan whereby it would write credit insurance available to borrowers. The plan called for Holding Company to create a life insurance subsidiary. The subsidiary's business would be to reinsure the risks of the credit insurance policies written by National for the customers of Utah Bank and Idaho Bank. Profits from the business could be retained in the subsidiary for investment. In its initial years, the subsidiary would utilize National's established and experienced operating services, such as actuarial and accounting, on a fee basis. If the plan proved successful, the new subsidiary could grow into a full-line, direct-writing insurance company.

Holding Company adopted National's plan and in June, 1954, incorporated First Security Life Insurance Company of Texas under the laws of Texas with an initial capital of \$25,000 and an initial paid-in surplus of \$12,500. The credit insurance written by National for the two banks was reinsured with Security Life under contracts called reinsurance treaties. Thereunder National received approximately 15%

of the premium dollar for its technical services and Security Life received the balance for its assumption of 100% of the risks under the policies. The maximum risk on one life under the policies reinsured by Security Life was \$5,000.

In 1956, Security Life's capital was increased to \$100,000. During the period it did not become a full-line, direct-writing insurance company. Although Security Life's business proved successful, this result was not assured at the outset. In relation to its capital structure Security Life reinsured a large amount of risk. As noted by the Tax Court, several aspects of its business could have invited high mortality rates. Customers of the banks obtained credit insurance without a health examination and without a waiting period. Also, Security Life was a relatively small insurance company and its policyholders lived in a relatively limited geographical area.

During the years in issue, Security Life paid state and federal taxes, used its own stationery, made deposits and withdrawals from bank accounts in its own name, and reinvested in its own name. Its sole source of business income was from reinsurance premiums. Its business expenses were primarily bank charges, taxes, and claims settlements. It paid a dividend to Holding Company of \$389,821.61 in 1959.

On September 15, 1959, as a result of a reorganization pursuant to the 1956 act regulating bank holding companies, see 12 U.S.C. § 1841 et seq., the Utah and Idaho banks became owned by First Security Corporation, a publicly held corporation, and Security Life became owned by First Security Investment Company, also a publicly held corporation. The parties have stipulated that as of February, 1967, there was a substantial difference in the ownership of the shares of the two companies.

On December 21, 1962, the Commissioner sent notices of deficiency to the taxpayers based on an allocation to the banks of approximately 47% of Security Life's premium income, during the years in issue, after payment of National's management fees. An alternative allocation was made to Management Company. On the authority of *Local Finance Corporation v. Commissioner of Internal Revenue*, 48 T.C. 773, affirmed, 7 Cir., 407 F. 2d 629, cert. denied 396 U.S. 956, the Tax Court upheld Commissioner's allocation of income to the banks and denied his alternative allocation

to Management Company. The banks have each appealed from the adverse decision on liability for tax deficiencies, and the Commissioner has taken a protective appeal from the conclusion of no deficiency due from Management Company.

Section 61 of the Internal Revenue Code of 1954, 26 U.S.C. § 61, defines gross income to mean all income from whatever source derived including, among specified items, "(1) Compensation for services, including fees, commissions, and similar items; (2) Gross income derived from business."

Section 482 of the Code, 26 U.S.C. § 482, covers allocations of income and deductions among taxpayers and provides that:

In any case of two or more organizations \* \* \* owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, \* \* \* if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, \* \* \*

In *Likins-Foster Honolulu Corp. v. Commissioner of Internal Revenue*, 10 Cir., 417 F. 2d 285, 292, cert. denied 397 U.S. 987, we recognized the purpose and effect of § 482, and the regulations thereunder. Treasury Regulations on Income Tax (1954), 26 C.F.R. § 1.482-1(b) and (c), provide that the standard to be applied in every case of a § 482 allocation "is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer" and that:

The authority to determine the true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

During the tax years in question Utah Bank, Idaho Bank, Management Company, and Security Life were all wholly owned subsidiaries of Holding Company and under its control. We are concerned with allocation of income from Security Life to the two banks. That income consists of a

portion of Security Life's share of premiums paid by borrowers from the banks and received by Security Life under its reinsurance treaties. The test to be applied is whether the banks' income with respect to the borrowers' purchase of credit insurance was other than it would have been had the banks in the conduct of their affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. *Davis v. United States*, 10 Cir., 282 F. 2d 623, 626. Application of that test to the facts presented is not easy.

The two banks are national banks. Section 92, 12 U.S.C., authorizes national banks located in a place having a population not to exceed 5,000 inhabitants to act as an insurance agent. In 1963, an administrative ruling by the Comptroller of the Currency purportedly authorized every national bank, regardless of where located, to enter the insurance agency field. That ruling was nullified by *Georgia Association of Independent Insurance Agents, Inc. v. Saxon*, N.D. Ga., 268 F. Supp. 236, affirmed 5 Cir., 399 F. 2d 1010, on the ground that, although § 92 does not explicitly prohibit banks in places with a population of over 5,000 from acting as insurance agents, it does so impliedly. In a different factual situation the Fourth Circuit held that a national bank is prohibited from operating an insurance department except in towns of less than 5,000 inhabitants. See *Commissioner of Internal Revenue v. Morris Trust*, 4 Cir., 367 F. 2d 794, 795. We agree.

Section 93, 12 U.S.C., provides that for any violation of the chapter on national banks, the franchise of the banking association shall be forfeited and the directors individually shall be liable for damages sustained. The Tax Court found that because of the statutory provisions, and the advice of counsel relating thereto, the banks believed that it would be contrary to federal banking law to receive income resulting from their customers' purchase of credit insurance and they have never received commissions or reinsurance premiums arising from credit insurance transactions.

The Commissioner argues that the inhibitions of the banking laws do not preclude the operation of the tax laws. The banks concede the supremacy of the federal tax laws. Their position is that because of the prohibitions of the federal banking laws the banks have consciously remained



aloof from any entitlement to income from the sale of insurance.

For the six years after the banks began offering credit insurance and before the formation of Security Life, the bank dealt exclusively with unrelated insurance companies in an uncontrolled situation. The Tax Court found that in the conduct of their affairs with these insurance companies the banks "never received or attempted to receive commissions or reinsurance premiums resulting from their customers' purchase of credit insurance." Conversely the Tax Court made no finding that if Security Life did not exist the banks would then receive or attempt to receive any such income. In an uncontrolled situation with arm's length dealing the banks, on the basis of the findings made, would not have taxable income from the credit insurance transactions.

When all the underbrush is cut away, the theory of the Commissioner appears as a claim that the generation of the credit insurance business by the banks sustains the allocation of a portion of the premium income to them. He relies on *Local Finance Corporation v. Commissioner of Internal Revenue*, *supra*. We turn to that decision.

Local Finance presents a fact situation quite comparable to that confronting us. Commonly owned Indiana small loan companies offered credit insurance to their borrowers and about 90% of those borrowers took the insurance at the rate of \$1.00 per year per \$100 of coverage. For a part of the period the insurer paid a guaranteed commission of 40% of the net premiums, plus certain extras, to an officer of the finance companies who, upon receipt, assigned the amount to the parent company. Later, a controlled life insurance company was organized and it reinsured the risks. Indiana law forbade finance companies from receiving any income other than interest on loans. Each finance office had a licensed insurance agent. The Commissioner allocated a portion of both the commission income and the reinsurance income to the parent. The rationale of the Tax Court opinion in *Local Finance* is not clear. We believe that dissenting Judge Fay's analysis is correct. He said, 48 T.C. 773 at 802:

The majority opinion also relies upon section 482 for support in allocating the income to petitioners in order to clearly reflect income. The premise of this

approach is the previously reached conclusion that petitioners have earned the income by the performance of various services and have exercised a power of disposition over this income to channel it to the reinsurance company.

In affirming the Tax Court, the Seventh Circuit said, 407 F. 2d 629 at 632 and 633:

The commissioner's allocation had the effect of compensating the finance companies for their efforts in generating and processing the life insurance.

However little the finance companies did to earn this money, they performed those minimal services which were the *sine qua non* of the insurance business.

The Commissioner now urges on us the generation of business theory. He says in his brief that "the effect of the Commissioner's allocation is to compensate Utah Bank and Idaho Bank for their efforts in generating and processing the credit insurance."

Generation of income differs from assignment of income. It is fundamental that a taxpayer cannot assign a portion of his income in order to avoid tax liability on it. See *Lucas v. Earl*, 281 U.S. 111. Also the power to dispose of income is the equivalent of ownership. *Helvering v. Horst*, 311 U.S. 112, 118. These principles are grounded on rights in or flowing from income. See *Poe v. Seaborn*, 282 U.S. 101, 117.

The position of the Commissioner in effect is that whoever generates income must include the amount thereof in his gross income. The fallacy of this position was exposed by the Tax Court in *Teschner v. Commissioner of Internal Revenue*, 38 T.C. 1003, 1007, when it said:

If this were the law, agents, conduits, fiduciaries, and others in a similar capacity would be personally taxable on the proceeds of their efforts. The charity fund-raiser would be taxable on sums contributed as the result of his efforts. The employee would be taxable on income generated for his employer by his efforts. Such results, completely at variance with every accepted concept of Federal income taxation, demonstrate the fallacy of the premise.

See also *Basye v. United States*, N.D. Calif., 295 F. Supp. 1289, 1292-1295.

Indeed, the acceptance of the generation of business theory would have alarming consequences on normal commercial practices such as all types of referral business and security commission giveups. See *Seieroe and Gerber*, "Section 482—Still Growing at the Age of 50," 46 Taxes 893, 900-902 (Dec. 1968). We believe that in principle it runs contrary to all court and Tax Court decisions except *Local Finance*.

From the standpoint of principle the case at bar is indistinguishable from such cases as *Nichols Loan Corporation of Terre Haute v. Commissioner of Internal Revenue*, 21 T.C.M. 805, reversed on other grounds, 7 Cir., 321 F. 2d 995 (deduction by small loan companies of expenses attributable to credit insurance); *Campbell County State Bank, Inc., of Herreid, South Dakota v. Commissioner of Internal Revenue*, 37 T.C. 430, reversed on other grounds, 8 Cir., 311 F. 2d 374 (attribution of income and expenses of commonly owned insurance agency to bank); *L. E. Shunk Latex Products, Inc. v. Commissioner of Internal Revenue*, 18 T.C. 940 (allocation to manufacturer of part of income of controlled outlet when manufacturer was prohibited by maximum price regulations from receiving the income sought to be allocated); *Jaeger Motor Car Company v. Commissioner of Internal Revenue*, 17 T.C.M. 1098, 7 Cir., 284 F. 2d 127, cert. denied 365 U.S. 860 (anticipatory transfer of insurance income from agent to controlled company); *Mohe Epstein, Inc. v. Commissioner of Internal Revenue*, 29 T.C. 1005 (insurance commissions received by president of taxpayer); and *Ray Waits Motors, Inc. v. United States*, E.D. S.Car., 145 F. Supp. 269 (insurance commissions received by president of taxpayer).

Even though the credit insurance emanated from the banks in connection with their loan business, the result does not follow that the banks should be taxed for income which they neither earned nor received. They did not earn it because (1) they were not licensed insurance agents, (2) they were impliedly prohibited by federal law from operating an insurance business, (3) their participation required minimal effort and negligible cost compatible with the added protection which they secured for loan payment, and (4) they had no underwriting risk. True it is that they physically received the premium payments but in so doing

they acted only as a conduit to pass them on intact to others who were legally entitled thereto.

Consideration of §§ 61 and 482 separately or in tandem does not change the result. The § 61 cases such as *Lucas v. Earl, supra*, and *Helvering v. Horst, supra*, are not pertinent because the banks neither assigned nor otherwise disposed of income. They simply had no income from the credit insurance business. We are unwilling to extend those decisions to situations where the taxpayer has the power to channel profitable business.

The test for allocations under § 482 is arm's length dealing with an uncontrolled taxpayer. As the Tax Court recognized, in arm's length dealings with independent insurers before the organization of Security Life the banks did not receive income from credit insurance premiums. In our opinion the change to the reinsurance arrangement with National and Security Life did not change the situation so far as the income of the banks is concerned. They handled the business in the same way and were under the same inhibitions. The change in operations was for the benefit of Holding Company, not the banks.

We recognize the established rules that substance prevails over form, that the Commissioner has a wide discretion which we may not upset unless it is used arbitrarily or capriciously, and that the burden of persuasion lies on the taxpayers. These do not change the result. Generation of business is not enough to impose federal income tax liability. The effect of the action of the Commissioner and the decision of the Tax Court is to allocate approximately \$800,000 in income to the banks and charge them with nearly \$400,000 in tax deficiencies thereon. The banks have not received, and in all probability never can receive, the income because of the present diverse public ownership of the parent of the banks and the parent of Security Life. We believe that the § 482 allocations made by the Commissioner are arbitrary and capricious and inconsonant with the basic concepts of federal income taxation. To the extent that this opinion is inconsistent with that in *Local Finance* we respectfully disagree with the decision.

Because it upheld the Commissioner's allocations of income to the banks, the Tax Court rejected his alternative allocation to Management Company. Counsel for the Commissioner say that there is an adequate basis for the alternative allocation but we cannot answer that question on



the record presented. It must be considered in the first instance by the Tax Court.

In Nos. 611-69 and 612-69 the judgments are severally reversed. In No. 613-69 the judgment is reversed and the case is remanded to the Tax Court for further consideration.

UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Nos. 611-69, 612-69, 613-69

[*Captions Omitted*]

JUDGMENT

Before Honorable Jean S. Breitenstein and Honorable Oliver Seth, Circuit Judges; and Honorable George Templar, District Judge.

January Term—January 21, 1971

These consolidated cases came on to be heard on the petitions for review from the United States Tax Court and were argued by counsel. On consideration whereof, it is ordered as follows:

1. In Cases Nos. 611-69 and 612-69 the decisions of the Tax Court are severally reversed.

2. In Case No. 613-69, the decision of the Tax Court is reversed and the case is remanded to the Tax Court for further consideration.

HOWARD K. PHILLIPS,  
*Clerk.*

By HELEN R. BARTHA,  
*Deputy Clerk.*

A true copy.

Teste.

Howard K. Phillips,  
*Clerk, U.S. Court of  
Appeals, Tenth Circuit.*

By Helen R. Barthra,  
*Deputy Clerk.*

SUPREME COURT OF THE UNITED STATES

No. 70-305

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

FIRST SECURITY BANK OF UTAH, N.A., ET AL.

ORDER ALLOWING CERTIORARI. Filed October 12, 1971.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Tenth Circuit is granted.

